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No.

In the

Supreme Court of the United States

October Term, 1989

STATE OF MISSISSIPPI and
MISSISSIPPI PUBLIC SERVICE COMMISSION,
Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTION PRESENTED

Whether a Federal Energy Regulatory Commission order, allocating an interstate utility system's nuclear plant investment costs among all the system's operating companies, is "unduly discriminatory" within the meaning of Sections 205 and 206 of the Federal Power Act when the order results in ratepayers in one state subsidizing those in another state.

PARTIES IN PROCEEDINGS BELOW

The following parties appeared in the proceedings before the District of Columbia Circuit:

(a) *Petitioners:*

1. State of Mississippi, also a petitioner before this Court.
2. Mississippi Public Service Commission, also a petitioner before this Court.
3. City of New Orleans.
4. Arkansas Public Service Commission.
5. State of Arkansas.
6. Arkansas-Missouri Congressional Delegation.
7. Missouri Public Service Commission.
8. Reynolds Metals Company.
9. Associated Industries of Arkansas.
10. Riceland Foods, Inc.
11. Weyerhauser Company.

(b) *Respondent:*

1. Federal Energy Regulatory Commission, also the respondent before this Court.

(c) *Intervenors:*

1. Jefferson Parish, Louisiana.
2. Louisiana Public Service Commission.
3. Occidental Chemical Corporation.
4. Georgia Gulf Corporation.
5. System Energy Resources, Inc.

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STATE OF MISSISSIPPI and
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Petitioners,

v.

FEDERAL ENERGY REGULATORY COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

The State of Mississippi and the Mississippi Public Service Commission, petitioners herein, respectfully pray that a writ of certiorari issue to review the opinion and judgment of the United States Court of Appeals for the District of Columbia Circuit rendered herein on May 26, 1989.

OPINIONS BELOW

The opinion of the District of Columbia Circuit, rendered on May 26, 1989, *sub nom. City of New Orleans v. F.E.R.C.*, is reported at 875 F.2d 903. It is reprinted in the Appendix hereto, p. 5a, *infra*.

An earlier opinion of the Circuit panel in this same proceeding, rendered on January 6, 1987, *sub nom. Mississippi Industries v. F.E.R.C.*, is reported at 808 F.2d 1525 and is reprinted in the Appendix hereto, p. 46a, *infra*. Circuit Judge Bork's concurring and dissenting opinion (808 F.2d at 1568-69), is reprinted in the Appendix hereto, p. 135a, *infra*. Certiorari was sought to review only the jurisdictional portions of the opinion (Part II), portions not presently in issue. Three petitions were filed, dealing with jurisdictional issues only, and certiorari was denied in all three cases, *sub nom. Arkansas Public Service Commission, et al., v. F.E.R.C.*, 484 U.S. 985 (1987).

On June 24, 1987, the *en banc* court of appeals entered an order denying suggestions for rehearing *en banc* on the remaining issues. 822 F.2d 1103. Simultaneously, the original panel of the court entered an order vacating its own prior denial of rehearing (814 F.2d 773), granted rehearing, vacated the relevant portions of the January 6 opinion, reversed the FERC allocation decision that was on appeal, and remanded the case to FERC for reconsideration in light of the issues raised by Judge Bork's dissent. That order is reported at 822 F.2d 1104, *sub nom. Mississippi Industries v. F.E.R.C.*

The pertinent FERC opinions, rendered following the remand by the court of appeals, are reported *sub nom. Systems Energy Resources, Inc.*, Opinion No. 292, 41 FERC ¶ 61,238 (Nov. 30, 1987), *reh. denied*, Opinion No. 292-A, 42 FERC ¶ 61,091 (Jan. 29, 1988). Opinion No. 292 is reprinted in the Appendix hereto, p. 11a, *infra*. Opinion No. 292-A is reprinted in the Appendix, p. 39a, *infra*.

JURISDICTION

The judgment and opinion of the District of Columbia Circuit were entered on May 26, 1989. Appendix, p. 5a, *infra*. Petitioners' timely petition for rehearing and suggestion for rehearing *en banc* were denied on August 28, 1989. Appendix, pp. 1a-4a, *infra*. On timely application, the Chief Justice on November 14, 1989, ordered that the time for filing this petition for certiorari be extended to and including December 27, 1989.

The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The pertinent statutory provisions are contained in Part II of the Federal Power Act, Secs. 205 and 206, 16 U.S.C. §§ 824-824k:

16 U.S.C. § 824(d)(a)

> *(a) Just and reasonable rates.* All rates and charges made, demanded, or received by any public utility for or in connection with the transmission or sale of electric energy subject to the jurisdiction of the Commission, and all rules and regulations affecting or pertaining to such rates or charges shall be just and reasonable, and any such rate or charge that is not just and reasonable is hereby declared to be unlawful.

16 U.S.C. § 824d(b):

> *(b) Preference or advantage unlawful.* No public utility shall, with respect to any transmission or sale subject to the jurisdiction of the Commission, (1) make

or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

16 U.S.C. § 824e(a):

(a) Unjust or preferencial rates, etc. Whenever the Commission, after a hearing had upon its own motion or upon complaint, shall find that any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force and shall fix the same by order.

STATEMENT OF THE CASE

This case represents the final chapter in a prolonged series of administrative and judicial review proceedings under the Federal Power Act. This chapter of the case raises an important question as to the meaning and application of the Act's command that the utility rates established by the Federal Energy Regulatory Commission (FERC) shall be just and reasonable, not "unjust, unreasonable, unduly discriminatory or preferential." 16 U.S.C. § 824e(a).

More specifically, this case raises the legal question whether

FERC misunderstood and therefore violated that statutory command when it reallocated, among the four operating utility companies of the Middle South Utilities system (MSU), the investment costs associated with the construction of MSU's Grand Gulf I nuclear plant. That plant, described by the court below as being "catastrophically uneconomical," cost more than three billion dollars to build. Appendix, p. 48a, *infra*. One of those operating utilities that absorbed a share of the Grand Gulf I costs is the Mississippi Power & Light Co. (MP & L), which serves customers throughout Mississippi. The State of Mississippi, a petitioner herein, represents the interests of the Mississippi consumers, while the petitioner Mississippi Public Service Commission has regulatory supervision over MP & L. Throughout these proceedings, the two petitioners have contended that the FERC reallocation formula is unduly discriminatory and unjust in terms of the resulting rates charged to Mississippi consumers, and thus violates the Act's "unduly discriminatory" proscription.

The procedural events leading to FERC's allocation of the Grand Gulf I costs have been before this Court on two recent plenary occasions.[1] In *Mississippi Power & Light Co. v. Mississippi*, 487 U.S. ____, 108 S.Ct. 2428 (1988), the Court recited these facts in some detail as a predicate to its holding that the FERC allocation of the Grand Gulf I costs pre-empted the Mississippi Supreme Court's inquiry into the prudence of the MSU management decisions that led to the construction and completion of Grand Gulf I. And last Term, in *New Orleans Public Service Inc. v. New Orleans*, 109 S.Ct. 2506 (1989), the Court briefly revisited these facts in the course of holding

[1]These same basic facts were also before the Court when it denied three petitions for certiorari seeking review of that portion of the decision of the court below that held that FERC had jurisdiction to make the reallocation of the Grand Gulf I costs, *sub nom. Arkansas Public Service Commission, et al. v. F.E.R.C.*, 484 U.S. 985 (1987).

that a federal court should not have abstained from reviewing a state ratemaking authority's decision that New Orleans Public Service, Inc. (NOPSI), one of the other MSU operating utilities, was entitled to less than full reimbursement for the FERC-allocated wholesale costs associated with Grand Gulf I.

Because the facts have been so thoroughly canvassed by this Court, particularly in the *Mississippi Power & Light* opinion, only the facts and issues surrounding the merits of the FERC allocation formula need now be set forth. This part of the story appropriately starts with the formation of the FERC formula, announced in *Middle South Energy, Inc.*, 31 F.E.R.C. ¶ 61,305 (1985). FERC there found that MSU, with its four operating utilities,[2] is a highly integrated and coordinated power pool. It also found that the construction and operation of its four nuclear power plants (including Grand Gulf I)[3] are primarily for the benefit of the system as a whole. *Id.*, at 61,645. FERC further found that the four nuclear units in the

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[2]The four operating utilities in the MSU system are:

(1) Mississippi Power & Light Co. (MP & L);
(2) New Orleans Public Service, Inc. (NOPSI);
(3) Louisiana Power & Light Co. (LP & L);
(4) Arkansas Power & Light Co. (AP & L).

[3]The four nuclear power units in the MSU system are:

(1) Grand Gulf I, located in Mississippi. It is the only MSU nuclear unit that supplies power to all four MSU operating companies. Originally, it was to be financed and constructed by MP & L, but that responsibility was later shifted from MP & L to a newly formed MSU generation subsidiary, Middle South Energy (now known as System Energy Resources, Inc.).

(2) Waterford III, located in Lousiana and operated by LP & L for the sole benefit of Louisiana ratepayers.

(3) ANO 1, located in Arkansas and operated by AP & L for the sole benefit of Arkansas ratepayers.

(4) ANO 2, also located in Arkansas and operated by AP & L for the sole benefit of Arkansas ratepayers.

system (including Grand Gulf I) had been planned "to meet overall System needs and objectives" and that "some form of equalization of nuclear plant costs [was] necessary to achieve just, reasonable, and non-discriminatory rates among the MSU operating companies." *Id.*, at 61,655.

FERC had received recommendations as to the proper allocation of the system's nuclear capacity costs from two of its administrative law judges, Judges Liebman and Head. To achieve what is called "nuclear capacity cost equalization" among the four operating companies, FERC adopted Judge Liebman's formula. *Id.*[4] FERC has steadfastly adhered to that formula.

The basic methodology of such an equalization formula is to equalize or balance (1) the total costs of the system's nuclear power units in proportion to (2) each operating company's relative contributions to system-wide demand for electric power from all sources, nuclear and non-nuclear — i.e., the amounts of system-generated power needed to satisfy the needs of each company's customers. But since Grand Gulf is the only nuclear power unit in the MSU system that benefits or contributes to the needs of all four operating companies, a fair formula should cover only the costs of Grand Gulf and not include the costs of the other three nuclear units that contribute no benefits to MP & L and NOPSI customers.

That kind of formulation was in essence proposed by Judge Head and supported by petitioners, though rejected by FERC. It would produce the following nuclear cost equalization:

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[4]Initially, Judge Liebman had rejected, as unduly discriminatory, an allocation proposed by SERI (the MSU subsidiary that operates Grand Gulf) that would have required Louisiana and Mississippi ratepayers to pay about four times more for nuclear power than the Arkansas ratepayers. See 808 F.2d at 1535, App. 64a, *infra*. Judge Liebman then proposed an allocation of Grand Gulf costs that was intended to achieve "nuclear capacity cost equalization" among the four operating companies.

	Grand Gulf costs	Demands on system
NOPSI	8%	8%
MP & L	15%	15%
AP & L	33%	33%
LP & L	44%	44%

Thus, under this formulation, each customer in the MSU system would bear its proportionate share of Grand Gulf's excessive cost, absent differences in retail rate treatment. And each customer would also receive the same proportionate share of Grand Gulf's benefits. No customer of a utility in one state would be subsidizing any part of the proportional costs of Grand Gulf allocable to a customer of another utility company in another state.

On the other hand, Judge Liebman's formulation, as approved by FERC, puts several significantly different factors into the cost equalization:

1. The Grand Gulf costs are added to the costs of the other three nuclear units in the system — Waterford III, ANO 1, and ANO 2 — so that each operating company bears a share of the total costs of all four nuclear plants in the MSU system in proportion to each company's relative contribution to system demand.

2. But at the same time, the formula neglects the fact that the benefits or output from Waterford III, ANO 1 and ANO 2 are not shared by the customers of MP & L or NOPSI. The output of Waterford III, a high cost facility, is for the exclusive benefit of the LP & L customers, while the output of ANO 1 and 2, relatively low cost units, is for the exclusive benefit of AP & L customers. This formulation simply ignores the fact that Grand Gulf is the only nuclear unit in the MSU system whose benefits are shared by all four operating companies.

This formula results in a skewed comparison between system nulcear costs and system benefits or usage, particularly as respects the MP & L and NOPSI ratepayers. Realistically, MP & L and NOPSI, and ultimately their customers, are forced to absorb a proportionate share of the costs of three nuclear plants — Waterford III, ANO 1 and ANO 2 — from which they get no benefits in terms of customer usage. A great disparity thus emerges, a disparity created by trying to divide the sum of all the nuclear investment costs by each company's relative demands on the system regardless of whether all nuclear units are used for the mutual benefit of all operating companies. This disparity is most dramatic in the case of MP & L and NOPSI, which are allocated comparative costs of four nuclear units while getting benefits from only one (Grand Gulf). To wit:

	Grand Gulf costs based on 4 nuclear unit allocation	Demands on system
NOPSI	17%	8%
MP & L	33%	15%
AP & L	36%	33%
LP & L	14%	44%

FERC's order thus allocates over twice as many Grand Gulf dollars to MP&L as to LP&L, to be absorbed by the MP&L service area having one-third of LP&L's electric consumption, a ratio of nearly 7 to 1.[5] Although the order allocates slightly more dollars to AP&L than to MP&L, AP&L has twice

[5]This ratio is derived by comparing the ratio of MP&L's allocation of Grand Gulf costs to LP&L's allocation (33% to 14%, or 2.36 times) to the ratio of LP&L's relative share of system load to MP&L's share (44% to 15%, or 2.93 times), resulting in a figure equal to 2.36 times 2.93, or 6.91.

the demand of MP&L — resulting in a ratio of 2 to 1 in terms of Grand Gulf costs.[6]

On the original appeal from the FERC equalization formula, Judge Bork in dissent noted another kind of disparity arising from FERC's formula. 808 F.2d at 1568, App. p. 135a, *infra*. Because of the relatively low costs of the two ANO units (used only by AP & L) and the high costs of the Waterford III unit (used only by LP & L), the costs per megawatt ("MW") of nuclear capacity allocated to each company under the FERC formula are as follows:

AP & L	**$ 858,000 per MW**
LP & L	**2,219,000 per MW**
MP & L	**2,156,000 per MW**
NOPSI	**2,094,000 per MW**

As Judge Bork noted, *id.*, such a "vastly disparate" allocation is virtually unchanged from the MW cost allocation originally proposed by the MSU system, an allocation that FERC had found unduly discriminatory. Judge Bork's point was that FERC had not adequately explained why its MW cost allocation was not also unduly discriminatory within the meaning of the Act. *Id.*, at 1569, App. p. 136a, *infra*. He noted that historically costs such as this were equalized among the four companies in the MSU system. That equalization is upset by the FERC formula. Judge Bork's remarks in this respect were one of the reasons the court below granted rehearing, vacated

[6]This ratio is derived by comparing the ratio of MP&L's allocation of Grand Gulf costs to AP&L's allocated costs (33% to 36%, or .92 times) to the ratio of AP&L's relative share of system load to MP&L's share (33% to 15%, or 2.2 times), resulting in a figure equal to .92 times 2.2, or 2.02.

its prior opinion, and remanded the case to FERC to explain and justify the Grand Gulf allocation.

The second reason for the remand to FERC for reconsideration of its formula was the second objection registered by Judge Bork's dissent. That objection went to FERC's decision to include the capacity costs of all four nuclear units in the equation. In Judge Bork's words, it is "not rational" to create an equation that includes "the capacity costs of all nuclear plants, rather than considering only the costs of Waterford III and Grand Gulf, or the costs of all coal and nuclear plants." *Id.* It is also irrational, in Judge Bork's view, to base the allocation on the costs of all four nuclear units when two of those units, ANO 1 and ANO 2, experienced no cost overruns.

On remand, FERC addressed Judge Bork's concerns, found them without merit, and reaffirmed its original cost-benefit allocation. Opinion 292, App. p. 11a, *infra*. FERC made the following comments:

1. The prohibition against undue discrimination requires that utility customers "be treated fairly, but not necessarily equally." App. pp. 17a-18a.

2. "Explicitly stated," wrote FERC, "our criteria for determining when undue discrimination exists in this case were that each operating utility should contribute investments to meet the capacity needs of the system in the long term, and that each operating utility should share in the overall capacity costs of the system in rough proportion to the benefits it receives (i.e., that its demand is met) from that system." App. p. 24a. But FERC did not quantify or otherwise explain what it meant by "rough equalization."

3. FERC's allocation of Grand Gulf capacity "will restore

the pattern of rough equalization of production costs which had previously existed among the MSU pool members, and its does so with as little disturbance to the manner in which the MSU system has conducted its integrated operations as is possible under the circumstances." App. pp. 23a-24a. FERC added that "an allocation scheme that would not achieve a rough equalization of production costs on a demand basis would be, in the absence of a rational explanation, unduly discriminatory because there would be no basis for disparity among similarly situated entities." App. p. 24a.

4. Judge Bork's opinion erred in assessing the fairness of the allocation by focusing upon installed nuclear investment costs per megawatt of nuclear *capacity* rather than upon installed nuclear investment costs per megawatts of *demand*. App. p. 20a. Generating capacity is built in order to meet system demand, and therefore the cost of capacity should be allocated throughout the system in proportion to demand. Under its formula, said FERC, any disparity in percentages of nuclear investment costs per megawatt of nuclear *demand* among the four operating companies has been virtually eliminated, citing these statistics: AP & L (101%); LP & L (101%); NOPSI (93%); MP & L (99%); Total Pool (100%). App. pp. 22a-23a.

5. With respect to Judge Bork's criticism that FERC sought to equalize the installment capacity costs of all four nuclear units, rather than simply Grand Gulf and Waterford III, FERC responded that all the nuclear units had been constructed for the benefit of the entire MSU system. App. p. 28a. The fact that those two units cost much more than the two ANO units was said to be due "simply to differences in timing as to when the units were built and by which company." *Id.* Since all four were built for "the benefit of the entire System," the ANO units stand on the same footing as Grand Gulf and Waterford

III — and therefore, "in order to restore the pattern of rough equalization of production costs, it is appropriate to focus on the total investment costs of *all* the nuclear plants built on the MSU System." *Id.*

6. As to the fact that Grand Gulf is the only nuclear unit that benefits all the four operating companies and their customers and as to the fact that none of the customers of MP & L or NOPSI share in the benefits of Waterford III or the ANO units, Opinion 292 said only that the nuclear units were planned, built and operated primarily for the benefit of the MSU system as a whole. App. p.44a.

7. FERC also sought to deflect focus on its mismatch of costs and benefits by citing numerous but vague "indirect benefits" that MP&L and NOPSI supposedly receive from the ANO and Waterford units. Without quantifying such benefits, FERC stated that these companies "benefit" from greater system fuel mix and "achieve" economies of scale in building new generation, reductions in reserve requirements, increased reliability and efficiencies in operation. App. p. 35a.

The court of appeals below denied the petitions for review of FERC's Opinion 292. App. p. 5a, *infra*. The court concluded, without any analysis other than to label the contents of Opinion 292 as reflective of "reasoned judgment," that (1) FERC "has fully and adquately reconsidered, on remand, its decision to equalize the capacity costs of all nuclear plants"; (2) FERC "has adequately explained its criteria for determining what constitutes 'undue discrimination'"; (3) FERC's judgment in this case "is not unduly discriminatory." App. p. 8a.

The court simply quoted with approval FERC's criteria for determining when undue discrimination exists. App. p. 9a. It made no independent examination or determination of what

constitutes undue discrimination under the Federal Power Act. And it made no effort to consider petitioners' argument that, under FERC's allocation, Mississippi and New Orleans consumers must subsidize consumers in other states or areas. In short, the court found FERC's formula to be rational, but did not address the rationality or discriminatory nature of the resulting impact on consumers located in various states.

REASONS FOR GRANTING THE WRIT

1. Important questions are raised as to the meaning and scope of judicial review of "unduly discriminatory" rates under the Federal Power Act.

Just a year and a half ago, in speaking of the very FERC allocation order here in issue, Justice Scalia observed that FERC has the responsibility "to protect against allocations [of the MSU nuclear investment costs] that have the effect of making the ratepayers of one State subsidize those of another." *Mississippi Power & Light Co. v. Mississippi*, 108 S.Ct. 2428, 2445 (1988) (Scalia, J. concurring). What he referred to is FERC's responsibility under the Federal Power Act, 16 U.S.C. § 824e(a), to assure that the rates charged to purchasers of electric energy at wholesale, and the contracts affecting such rates, are not "unjust, unreasonable, unduly discriminatory or preferential." Thus the thrust of Justice Scalia's comment is that an allocation that results in making the ratepayers of one State subsidize those in another State approximates a ***per se*** violation of the statutory "unduly discriminatory" standard.

This case brings into sharp focus the viability of Justice Scalia's description of an "unduly discriminatory" rate. As petitioners have persistently argued, we have here precisely

the kind of interstate subsidy that incurs what Justice Scalia would label unduly discriminatory. As we have seen (p.9, *supra*), FERC's allocation order has the following result: Mississippi customers of MP & L and New Orleans customers of NOPSI, who share none of the benefits of the ANO units in Arkansas or the Waterford III unit in Louisiana, necessarily subsidize part of the Arkansas-Louisiana customers' rates for using the ANO-Waterford output. Does that not constitute "undue discrimination"? And, given the failure of the court below even to address this problem, this Court should determine if such a subsidy constitutes discrimination. That was a question the Court did not have to address in the *Mississippi Power & Light* case. Nor has the Court answered this question in any other case.

There are, of course, several other elements to be addressed in resolving this issue of discrimination: (1) what is the proper standard of judicial review respecting this issue? and (2) does an allocation based on system-wide demand and system-wide costs justify an intra-system discrimination?

1. As to judicial review, the court below — despite Justice Scalia's clear warning — professed complete satisfaction with FERC's rationalization of its allocation order. It was said to be enough, for judicial review purposes, that on the remand FERC had "fully and adequately reconsidered" its allocation, "explained its criteria," and entered a "reasoned judgment" that its allocation achieved "rough equalization" and thus was not "unduly discriminatory" from a system-wide standpoint.

Such total deference to an administrative ratemaking decision is at odds with this Court's precedents. Long ago the Court held that, where neither the Constitution nor Congress has established an "unduly discriminatory" standard, it is the responsibility of the ratemaking agency to create a workable and reasonable formula. And while a court is not free to sub-

stitute a formula it considers more appropriate, the court may examine the results of the application of the agency's formula. Judicial review is thus limited to examining the impact of the agency's order, "as applied to the facts" and "viewed in its entirety," to make sure that the prescribed rates fall within a "zone of reasonableness" and that the formula "produces no arbitrary result." *F.P.C. v. Natural Gas Pipeline Co.*, 315 U.S. 575, 585-586 (1942). To same effect, see *Permian Basin Area Rate Cases*, 390 U.S. 747, 767 (1968). Or, as stated in *F.P.C. v. Hope Natural Gas Co.*, 320 U.S. 591, 602 (1944), "it is the result reached not the method employed which is controlling . . . It is not theory but the impact of the rate order which counts. If the total effect of the rate order cannot be said to be unjust and unreasonable, judicial inquiry under the Act is at an end." But that inquiry must also ask whether FERC's allocation order is supported by substantial evidence and reflects reasoned decision-making. *Burlington Truck Lines, Inc. v. United States*, 371 U.S. 156, 167-168 (1962)

The court below seems to have abdicated its limited but essential review function under the Federal Power Act. The court did no more than say that FERC "adequately explained its criteria for determining what constitutes 'undue discrimination,'" App. 8a, *infra*, and that FERC exhibited a "reasoned judgment" in determining that an allocation would be "unduly discriminatory" if it "would not achieve a rough equalization of production costs on a demand basis." App. 9a, *infra*. But where is the judicial inquiry into "the total effect" of the order, particularly as it impacts on the ratepaying customers in Mississippi and New Orleans?

2. FERC's notion of the criteria for determining if the rates resulting from the allocation are "unduly discriminatory" raises serious questions. As approved by the court below, the FERC test of undue discrimination is whether, on a system-wide

basis, the allocation scheme achieves "a rough equalization [among the operating companies] of production costs on a demand basis." To avoid discrimination, says FERC, "each operating company should contribute investments to meet the capacity needs of the system in the long term, and that each operating utility should share in the overall capacity costs of the system in rough proportion to the benefits it receives (*i.e.*, that its demand is met) from that system." See App. p. 9a, *infra*. "Rough equalization" may well be the inevitable result of factoring unquantifiable "indirect benefits" into the allocation formula.

Such concentration on overall system-wide costs and benefits (direct and indirect) in setting the allocation proportions is precisely what causes the "unduly discriminatory" problems. That concentration ignores the fact that not all operating companies share in the benefits of all the nuclear plants. Thus if the Mississippi and New Orleans customers never share in the benefits of the power generated by the system's Arkansas and Louisiana nuclear units, how can there be any fair equalization of system-wide costs and benefits, rough or otherwise? In this situation, are not the Mississippi and New Orleans customers subsidizing the costs of some of the benefits which Arkansas and Louisiana customers receive from the system's nuclear power units, units which are designed and operated for their exclusive use?

This intra-system discriminatory scheme raises the ultimate question whether the scheme can be justified by the highly integrated nature of the MSU system. Does such integration justify a departure from the bed-rock allocation principle that costs must match benefits in order to avoid cross-subsidization within the system? By concentrating on system-wide equalization, FERC has lost sight of the unfairness that its allocation scheme may visit upon individual operating companies and their

rate-paying customers. Only this Court can now determine if that allocation should be altered to restore the degree of intra-system fairness that is necessary to avoid the "unduly discriminatory" label. And in that process, meaningful content can be given to the broad statutory concept of "unduly discriminatory."

2. The absence of controlling precedent in this Court makes the grant of certiorari compelling.

While this Court has held that ratemaking under the Federal Power Act must come within the "zone of reasonableness," *F.P.C. v. Natural Gas Pipeline Co.*, 315 U.S. at 585, no decision has yet tested an interstate intra-system scheme of allocating costs and benefits of nuclear power plants for compliance with the Federal Power Act's requirement that the resulting rates not be "unduly discriminatory." Nor has the Court had occasion to give much content to the Act's nondiscrimination standard.

The need for some definitive articulation of what is and what is not a discriminatory rate structure is compounded by the refusal or inability the court below to even address, let alone resolve, this problem of interstate-intrasystem discrimination. This problem has an obvious and substantial impact upon the rate-paying customers in Mississippi and New Orleans, as well as upon the electric rates and economic conditions in a region suffering economic depression.

In his concurring opinion in *F.P.C. v. Natural Gas Pipeline Co.*, 315 U.S. at 606-607, Justice Black wrote that the concept of "just and reasonable" rates embraces not only the investor interest but the consumer interest as well. "The consumer interest cannot be disregarded," he wrote, "in determining what is a 'just and reasonable' rate. Conceivably, a

return to the company of the cost of the service might not be 'just and reasonable' to the public." Justice Black added that, if "the rights of the public are not to be ignored," there must be "an inquiry as to what is reasonable and just for the public" so as to avoid being "grossly unfair to the consumers." *Id.*, at 608. The instant case affords an opportunity for the Court to renew and apply what Justice Black described as a universal consumer interest in paying "just and reasonable" utility rates.

Moreover, because there is a strong national interest in truly equalizing the costs of nuclear power among investors and consumers, as well as in reviving and utilizing the valuable sources of nuclear power that exist, this case and this issue reflect a national importance that warrants the grant of certiorari.

FERC's allocation in this case also sets a national pattern for allocating the high and often excessive costs of nuclear energy. This is especially true in light of the national trend toward placing nuclear power generators under the control of separate production subsidiaries — such as MSU's separate nuclear production subsidiary, System Energy Resources, Inc. — rather than under local or system operating utilities.[7] This Court's ruling in *Mississippi Power & Light* makes clear that the rate structures imposed by such subsidiaries, and particularly the MSU subsidiary, fall within FERC's exclusive jurisdiction. These interstate system-wide nuclear operations are therefore free of most direct regulations by the state utility commissions. And so if FERC is free to establish a rate structure in this case that causes ratepayers in one state to subsidize those of another, a most unfortunate and discriminatory

[7]See Sillen and Jackson, *Nuclear Generating Companies: A Framework for Reviving Nuclear Power*, Public Utilities Fortnightly (Nov. 23, 1989), p. 23 (such separate companies "would be at least one step removed from state regulatory jurisdiction and would be under that of FERC")

precedent will be established, a precedent of nationwide proportions.

In *Mississippi Power & Light*, this Court recognized the national pace-setting nature of the jurisdictional problems embedded in the MSU system. The time has now come to recognize and resolve the national pace-setting nuclear cost allocation problems emerging from the interstate MSU system.

CONCLUSION

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

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December 27, 1989

APPENDIX

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 88-1067

City of New Orleans,
Petitioner

v.

Federal Energy Regulatory Commission
Respondent

---

and Consolidated Case Nos.: 88-1068, 88-1124, 88-1198

BEFORE: Edwards, Silberman and Buckley, Circuit Judges

O R D E R

Upon consideration of the motion of Petitioner City of New Orleans For Leave To File It's Petition For Rehearing, One Day Out of Time, the petition for rehearing of the Mississippi Attorney General and the Mississippi Public Service Commission (Mississippi Parties), the motion of the Mississippi Parties to substitute an amended petition for rehearing, Intervenors' motion to strike in part, the responses therto and of the reply, it is

ORDERED, by the Court, that the motion of the City of New Orleans for leave to file out of time is denied and it is

FURTHER ORDERED, by the Court that the motion of the Mississippi Parties to substitute an amended petition is granted and it is

FURTHER ORDERED, by the Court, that the petition for rehearing of the Mississippi Parties is denied and it is

FURTHER ORDERED, by the Court, that the motion to strike is dismissed as moot.

Per Curiam
FOR THE COURT:
CONSTANCE L. DUPRE, CLERK

BY: /s/ Robert A. Bonner
Robert A. Bonner
Deputy Clerk

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United Court of Appeals
For the District of Columbia Circuit
FILED AUG 28 1989
CONSTANCE L. DUPRE
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UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 88-1067 September 1988

City of New Orleans,
Petitioner

v.

Federal Energy Regulatory Commission
Respondent

---

and Consolidated Case Nos.: 88-1068,88-1124, 88-1198

BEFORE: Wald, Chief, Judge; Robinson, Mikva, Edwards, Ruth B. Ginsburg, Silberman, Buckley, Williams, D.H. Ginsburg and Sentelle, Circuit Judges

ORDER

Upon consideration of the motion of Petitioner City of New Orleans For Leave To File A Suggestion For Rehearing *En Banc* One Day Ouit of Time, the Suggestion For Rehearing *En Banc* of the Mississippi Attorney General and the Mississippi Public Service Commission (Mississippi Parties), the motion of the Mississippi Parties for Leave To Substitute An Amended Suggestion, Intervenors' Motion to Strike in Part the Suggestions For Rehearing *En Banc*, the responses thereto and of the reply, it is

ORDERED, by the Court *en banc*, that the motion of the city of new orleans for leave to file out of time is denied and it is

FURTHER ORDERED, by the Court *en banc*, that the motion of the mississippi parties for leave to file an amended suggestion for rehearing *en banc* is granted and, no member of the Court having requested the taking of a vote thereon, it is

FURTHER ORDERED, by the Court *en banc*, that the suggestion for rehearing *en banc* of the Mississippi Parties is denied and it is

FURTHER ORDERED, by the Court *en banc*, that the motion to strike the suggestion in part is dismissed as moot.

Per Curiam
FOR THE COURT:
CONSTANCE L. DUPRE, CLERK

BY: /s/ Robert A. Bonner
Robert A. Bonner
Deputy Clerk

Chief Judge Wald did not participate in this order.

Notice: This opinion is subject to formal revision before publication in the Federal Reporter or U.S.App.D.C. Reports. Users are requested to notify the Clerk of any formal errors in order that corrections may be made before the bound volumes go to press.

United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued May 8, 1989 Decided May 26, 1989

No. 88-1067

CITY OF NEW ORLEANS, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

JEFFERSON PARISH, LOUISIANA,
OCCIDENTAL CHEMICAL CORPORATION,
SYSTEM ENERGY RESOURCES, INC.,
LOUISIANA PUBLIC SERVICE COMMISSION,
ARKANSAS PUBLIC SERVICE COMMISSION, et al.,
MISSISSIPPI PUBLIC SERVICE COMMISSION, INTERVENORS

No. 88-1068

STATE OF MISSISSIPPI, EX REL ATTORNEY GENERAL,
PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

No. 88-1124

MISSISSIPPI PUBLIC SERVICE COMMISSION, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

No. 88-1198

ARKANSAS PUBLIC SERVICE COMMISSION, et al., PETITIONERS

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

Petitions for Review of an Order of the Federal Energy Regulatory Commission

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Glen L. Ortman, with whom *Clinton A. Vince* and *Paul E. Nordstrom*, for City of New Orleans, and *Robert Franklin Spencer*, for State of Mississippi, were on the joint brief, for petitioners in Nos. 88-1067, 88-1068 and 88-1124. *Sherry A. Quirk* also entered an appearance for petitioner, City of New Orleans. *Richard W. Wise* and *Dennis Miller* entered appearances for petitioner, Mississippi Public Service Commission.

Steve Clark, Attorney General, State of Arkansas, and *Mary B. Stallup*, Deputy Attorney General, State of Arkansas, for State of Arkansas, *A. Raymond Randolph* and *Daniel I. Prywes*, for Reynolds Metals Company, et al., *Wallace L. Duncan*, *James D. Pembroke* and *Janice L. Lower*, for Arkansas Public Service Commission, and *William Massey*, for Arkansas-Missouri Congressional Delegations, were on the brief for petitioners in No. 88-1198 and intervenors in Nos. 88-1067, 88-1068

and 88-1124. *Thomas Byrne* entered an appearance, for Missouri Public Service Commission.

Samuel Soopper, Attorney, Federal Energy Regulatory Commission, with whom *Catherine C. Cook*, General Counsel, and *Jerome M. Feit* Solicitor, Federal Energy Regulatory Commission, were on the brief, for respondent. *John Estes* and *Hanford O'Hara*, Attorneys, Federal Energy Regulatory Commission, also entered appearances for respondent.

Michael R. Fonham and *Theodore L. Jones*, for Louisiana Public Service Commission and the State of Louisiana, *Earle H. O'Donnell* and *Robert R. Morrow*, for Occidental Chemical Corporation and Georgia Gulf Corporation, and *Richard G. Morgan*, for Jefferson Parish, Louisiana, were on the joint brief for intervenors, in Nos. 88-1067, 88-1068, 88-1124 and 88-1198.

Richard M. Merriman, *Robert S. Waters* and *James K. Mitchell* were on the brief, for intervenor Systems Energy Resources, Inc., in Nos. 88-1067, 88-1068, 88-1124 and 88-1198.

Dennis Miller and *Richard W. Wise* also entered appearances, for intervenor Mississippi Public Service Commission, in Nos. 88-1067, 88-1068 and 88-1198.

Clinton A. Vince, *Glen L. Ortman*, *Paul E. Nordstrom* and *Sherry A. Quirk* also entered appearances, for intervenor City of New Orleans, in Nos. 88-1124 and 88-1198.

Before: EDWARDS, SILBERMAN and BUCKLEY, *Circuit Judges.*

ORDER

PER CURIAM: The petitions for review in this case follow a remand from this court to the Federal Energy Regulatory Commission ("FERC" or "the Commission") for further explanation of the Commission's 1985 decision allocating the cost of generating electricity among the operating companies of the Middle South Utilities

System. In particular, the case was remanded to the Commission "for reconsideration of the decision to equalize the capacity costs of all nuclear plants, and for an explanation of the criteria used to determine what constitutes 'undue discrimination' and of why the Commission's ultimate decision is not unduly discriminatory." *Mississippi Indus. v. FERC*, 822 F.2d 1104, 1105 (D.C. Cir.), *cert. denied*, 108 S. Ct. 501 (1987). To the extent that the present petitions for review seek to raise jurisdictional issues, we summarily reject them. This court already has upheld the Commission's exercise of jurisdiction in this case, and that issue is not properly the subject of further litigation. *See Mississippi Indus. v. FERC*, 808 F.2d 1525 (D.C. Cir.), *vacated in part on other grounds*, 822 F.2d 1104 (D.C. Cir), *cert. denied*, 108 S. Ct. 501 (1987).

On the record now properly before this court, we find the following: first, the Commission has fully and adequately reconsidered, on remand, its decision to equalize the capacity costs of all nuclear plants; second, FERC has adequately explained its criteria for determining what constitutes "undue discrimination;" and, third, the Commission's judgment in this case is not unduly discriminatory.

In its opinion, the Commission explained that

> [p]rinciples of fairness in ratemaking support the concept that those who are responsible for the incurrence of costs be the ones who bear those cost burdens. Generating capacity is built in order to meet demand. Therefore, the cost of capacity should be allocated throughout an electric utility system in proportion to demand.

System Energy Resources, Inc., 41 F.E.R.C. ¶ 61,238 at 61,616 (Nov. 30, 1987) (citation omitted), *aff'd*, 42 F.E.R.C. ¶ 61,091 (Jan. 29, 1988). According to the

Commission, "[a] cost equalization approach that fails to consider demand would ignore the very determinant that controls the need for various levels of capacity." *Id.* We can find no basis in the record to reject these findings of the Commission.

The Commission also explained that its criteria for determining when undue discrimination exists "were that each operating utility should contribute investments to meet the the [sic] capacity needs of the system in the long term, and that each operating utility should share in the overall capacity costs of the system in rough proportion to the benefits it receives (*i.e.*, that its demand is met) from that system." *Id.* at 61,617. This reflects reasoned judgment, because "an allocation scheme that would not achieve a rough equalization of production costs on a demand basis would be, in the absence of a rational explanation, unduly discriminatory because there would be no basis for disparity among similarly situated entities." *Id.*

Finally, the Commission also found that a proportionate allocation of nuclear investment costs was justified by the indirect benefits provided by the nuclear units to all the companies. *Id.* at 61,622. For example, because of the existence of the Arkansas Nuclear One station, Arkansas Power & Light Company has extra coal-fired generation, which may become available to other companies in the pool. *See System Energy Resources, Inc.*, 42 F.E.R.C. at 61,425. Furthermore, the presence of the nuclear units in the integrated system helps to achieve economies of scale, reductions in reserve requirements, increased reliability and efficiencies in operation. *See System Energy Resources, Inc.*, 41 F.E.R.C. at 61,622-23.

In light of the foregoing findings and explanations, we find no merit in the petition for review. Indeed, the petitioner, while opposing the Commission's current judg-

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ment, offers no alternative for the allocation of nuclear investment costs other than to return to a method that FERC rejected with our approval. *See* 808 F.2d at 1555-56. In short, the petitioner's challenge in this case provides no basis whatsoever for disturbing the Commission's decision. Accordingly, we reject this challenge because we conclude that FERC's action was both rational and within the Commission's range of discretion to remedy unduly discriminatory rates.

ORDERED and ADJUDGED that the motion for summary affirmance on the jurisdictional issue be granted; and that the petition for review be denied.

Federal Energy Regulatory Commission

[¶61,238]

System Energy Resources, Inc., Docket No. ER82-616-032; MSU Systems Resources, Inc., Docket No. ER82-483-028

Opinion No. 292; Opinion and Order on Remand Reaffirming Prior Allocation

(Issued November 30, 1987)

Before Commissioners: Martha O. Hesse, Chairman; Anthony G. Sousa, Charles G. Stalon, Charles A. Trabandt and C.M. Naeve.

[Opinion No. 292 Text]

On June 24, 1987, the United States Court of Appeals for the District of Columbia Circuit issued an order: (1) granting petitions for rehearing of the opinion issued on January 6, 1987, in *Mississippi Industries v. FERC*, 808 F.2d 1525 (D.C. Cir. 1987); (2) reversing, for the reasons stated in the dissent to that opinion, the Commission's decision issued in *Middle South Energy, Inc.*, Opinion No. 234-A, 32 FERC ¶61,425 (1985); (3) remanding the case for reconsideration by the Commission of its decision to equalize the capacity costs of all nuclear plants on the Middle South Utilities, Inc. (Middle South or MSU) System, and an explanation as to (1) the criteria used to determine "undue discrimination," and (b) why the allocation chosen by the Commission is not unduly discriminatory; and (4) vacating those portions of the panel's January 6, 1987 opinion, 808 F.2d at 1560-63, which addressed the two issues specified in (3) and the judgment of the court insofar as it concerned those issues: *Misssissippi Industries v. FERC*, 822 F.2d 1104 (D.C. Cir. 1987).

I

In Opinion No. 234, we considered the justness and reasonableness of the Grand Gulf Unit Power Sales Agreement (UPSA) filed by Middle South Energy, Inc.[1] and the 1982 Middle South System Agreement (System Agreement) filed by Middle South Services, Inc.[2] on behalf of the four operating utilities of the Middle South System which comprise the MSU "Pool" - Arkansas Power & Light Company (AP&L), Louisiana Power & Light Company (LP&L), Mississippi Power & Light Company (MP&L), and New Orleans Public Service, Inc. (NOPSI). We concluded that the UPSA as filed in conjunction with the System Agreement failed to allocate costs among those four operating utilities so as to produce rates which were just, reasonable, and non-discriminatory. We determined that capacity from the Grand Gulf Nuclear Generating Station Unit No. 1 (Grand Gulf) should be allocated among the four operating utilities so that responsibility among them for installed System nuclear investment costs was equalized. 31 FERC at p. 61,655.

On rehearing, we reaffirmed our decision, stating that it was intended "to eliminate drastic rate disparities at the wholesale rate level which are associated with units used for the mutual benefit of all companies, and to do so in a manner which disturbs the historical operation of the System as little as possible, and which allows the individual companies to retain as fully as possible the benefits of units they have financed and constructed. In other words, we have sought to achieve an equit-

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[1]Middle South Energy, Inc. subsequently changed its name to System Energy Resources, Inc. (SERI) is a generating subsidiary of MSU. It is not a member of the Middle South "Pool," subject to the terms of the System Agreement. MP&L, a member of the pool, constructed Grand Gulf and, until recently, operated the plant on behalf of SERI.

[2]Middle South Services, Inc. subsequently changed its name to MSU System Resources, Inc.

able balance between the interests of the individual companies and the System as a whole, consistent with the System Agreement." 32 FERC at p. 61,959.

On appeal, the court unanimously held that the Commission possessed jurisdiction to impose the remedy selected in the case. As to the merits of that remedy, a majority of the panel affirmed the Commission's decision, with one judge dissenting in part. The dissent found that the Commission had failed to explain adequately two issues. First, the dissent found that the agency had not adequately explained its criteria for determining what is "undue discrimination" or why the course chosen by it was not unduly discriminatory. It noted that the UPSA as filed by SERI resulted in the Middle South operating utilities' bearing nuclear capacity costs as follows:

AP&L — $531,000/MS
LP&L - $2,211,000/MW
MP&L - $2,247,000/MW
NOPSI - $2,090,000/MW

The allocation chosen by the Commission, on the other hand, produced the following result:

AP&L - $858,000/MW
LP&L - $2,219,000/MW
MP&L - $2,156,000/MW
NOPSI - $2,094,000/MW

The dissent noted that the disparities in nuclear capacity costs among the pool members had changed hardly at all. It also found the explanation offered on rehearing to be inadequate for three reasons. First, the Commission had not explained why the remaining disparities were not "drastic" and "unduly discriminatory." Second, the desire not to disturb the historical operation of the System did not support our decision because, historically, costs were, the dissent stated, equa-

lized. Third, the rationale of attempting to allow individual companies to retain as fully as possible the benefits of the units they have constructed was inconsistent with the premise that the companies are not autonomous and that decisions are made for the benefit of the System as a whole.[3]

The dissent further found that the Commission's explanation for its decision to include the capacity costs of all nuclear plants, rather than only the costs of Grand Gulf or Waterford 3, or the capacity costs of all coal and nulcear plants, was not rational. To the extent the Commission was attempting to address "unique" cost overruns, it would seem reasonable to consider only the costs of Grand Gulf and Waterford 3. If the Commission wished to include the costs of AP&L's ANO nuclear units, then it appeared that we should have also included the costs of the System's coal units, whose investment costs were comparable to the ANO units. 808 F.2d at 1568-69. As indicated previously, a majority of the panel adopted the dissent's reasoning in support of its order to remand the Commission's decision for further consideration.

On July 24, 1987 [40 FERC ¶ 61,078], the Commission issued an order inviting comments from the parties as to what action we should take in light of the matters remanded by the court. Comments were filed by SERI, the City of New Orleans, Louisiana, the Mississippi Attorney General, and the Mississippi Public Service Commission (Mississippi Commission) (the three parties are collectively referred to as CNO, *et al.*); Mississippi Industries; Occidental Chemical Corporation, Georgia Gulf Corporation, and Jefferson Parish, Louisiana (OCC, *et al.*); Union Carbide Corporation (Union Carbide); the Arkansas-Missouri Congressional Delegation; the

[3]In fact, we found that production costs were *roughly* equalized, and that decisions to install generatingl capacity were made *primarily* for the benefit of the system as a whole *See* pages 6-10, *infra*.

Louisiana Public Service Commission, and the State of Louisiana (Louisiana); the Arkansas and Missouri Public Service Commissions, and the State of Arkansas (Arkansas Commission, *et al.*).[4]

SERI contends that undue discrimination must be analyzed by reference to nuclear investment costs per megawatt of demand, rather than per megawatt of nuclear capacity. As to the appropriate allocation, SERI recommends that the Commission readopt the allocation chosen in Opinion No. 234 rather than the two alternatives suggested in the dissent. In the event we do not readopt the prior allocation, SERI requests that the Commission make any new allocation effective following a sufficient period of time to allow the MSU operating utilities to obtain retail rate relief reflecting the new allocation.[5] and that no refunds be required.

OCC, *et al.*, Louisiana, and Union Carbide also recommend that we assess undue discrimination on a demand basis, and that the Commission reaffirm the allocation previously ordered. As to the two alternatives suggested in the dissent, OCC, *et al.* and Louisiana suggest that the equalization of Grand Gulf and Waterford 3 is preferable to equalizing investment in all coal and nuclear generation, although they state that all generation costs, not simply investment costs, of the two nuclear units should be equalized.

Mississippi Industries request that the Commission remand the case to an administrative law judge for hearings in order to place into effect some form of production cost equalization.

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[4]Several of these parties filed comments *sua sponte* prior to our July 24 order. To the extent necessry, we accept those comments for filing, as well as the supplemental comments filed by the Louisiana parties on September 10, 1987, and by various Arkansas-Missouri parties on September 25, 1987.

[5]SERI suggests one year as a reasonable period of time.

several proposals of which were advocated by participants in this case.

CNO *et al.* advocate that the Commission adopt the allocation recommended by Presiding Judge Head in Docket No. ER82-483, i.e., that each MSU operating utility be given a share of Grand Gulf in proportion to its share of annual System demand, without reference to the companies' prior investment in nuclear generation. In the event that the Commission adopts a Grand Gulf-Waterford 3 allocation, only the "excess" costs of the latter unit should be included.

The Arkansas Commission *et al.*, supported by the Arkansas-Missouri Congressional delegation, contend that the Commission lacks jurisdiction to order any change in the UPSA or System Agreement which reallocates production plant among the MSU operating utitlities. Assuming that such jurisdiction exists, the Arkansas Commission suggests that four alternatives exist. First, the Commission may decide that the MSU operating utilities are autonomous, in which case no discrimination exists. Second, the Commission may decide that the MSU operating utilities are autonomous, but that Grand Gulf was built to serve the needs of more than one company. In that event, Grand Gulf should be allocated to LP&L, MP&L, and NOPSI. Third, the Commission may determine that the MSU operating companies have some characteristics of autonomy and some characteristics of a "monolithic" system. In that case, the Commission should choose an equalization scheme which preserves state regulatory authority over generating facilities to the maximum extent possible. Fourth, the Commission may decide that the MSU System is a single, "monolithic" entity. In that event, the Commission should not adopt a remedy which creates more discrimination than it cures. Equalization of the production costs of all nuclear and coal capacity, or the production costs of all Grand Gulf and Waterford 3 alone, would allegedly exacerbate discrimination

in production costs among the MSU companies. In their reply comments, however, the Arkansas Commission *et al.* advocate that Grand Gulf be allocated, assuming that authority to do so exists, so as to equalize (on a demand basis) coal and nuclear investment costs.

The Mississippi Commission, in separate reply comments, reiterates the view that Grand Gulf is an anomaly to the historical operation of the MSU System, because it is the only plant financed and owned by a separate subsidiary, and argues for the allocation chosen by the presiding judge in Docket No. ER82-483. If the Commission rejects that allocation, then Grand Gulf should be allocated in such a way as to directly equalize all prdouction costs on the System, rather than through the "indirect" manner chosen in Opinion No. 234.

II

Section 205(a)[6] of the Federal Power Act (FPA or Act) requires that all rates and charges be just and reasonable. Section 205(b)[7] of the Act, in turn, provides:

> No public utility shall . . . (1) make or grant any undue preference or advantage to any person or subject any person to any undue prejudice or disadvantage, or (2) maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, either as between localities or as between classes of service.

The prohibition against undue discrimination requires that utility customers be treated fairly, but not necessarily equal-

[6]16 U.S.C. § 824d(a) (1982).
[7]16 U.S.C. § 824d(b) (1982).

ly. *City of Frankfort v. FERC*, 678 F.2d 699, 704 (7th Cir. 1982); *see also St. Michaels Utilities Comm'n v. FPC*, 377 F.2d 912 (4th Cir. 1967). Disparities in rate treatment among customers are prohibited unless justified by factual differences. *Public Service Co. of Indiana v. FERC*, 575 F.2d 1204 (7th Cir. 1978).

The MSU System is an integrated system organized pursuant to the provisions of the Public Utility Holding Company Act of 1935 (PUHCA).[8] Generation facilities are planned, constructed, and operated primarily for the benefit of the System as a whole. 31 FERC at pp. 61,645 and 61,655; 808 F.2d at 1555-57. Historically, System membership and pool membership were identical. Currently, with the advent of SERI, the System Agreement is limited to establishing charges among the four vertically-integrated operating utilities and serves to allocate, *inter alia*, production costs among those pool members. The UPSA, in turn, independently allocates the costs of capacity and energy from Grand Gulf to each of the of our pool members. Consequently, the UPSA affects rates under the System Agreement. 32 FERC at pp. 61,949.50; *Middle South Energy, Inc.*, 31 FERC ¶ 61,304 (1985). Application of the FPA's prohibition against undue discrimination to the circumstances of this case requires that total production costs, which include both capacity-related costs and energy-related costs, on the entire System be allocated fairly among the members of the MSU Pool. Therefore, in Opinion No. 234, our ultimate concern lay with production costs and the allocation of those costs among the MSU pool members.

The record in Opinion No. 234 established that production costs among the the MSU System's non-nuclear units were roughly equivalent. 26 FERC at p. 65,110; Docket No. ER82-616, Exh. 41, pp. 7-11; Exh. 125; Tr. 803-4, 2201,

[8] 15 U.S.C. § 79 *et sea.* (1982).

2227, 2229. Furthermore, the record established that the cost of fuel, which accounts for the majority of energy-related costs, was approximately the same for each of the nuclear plants. Docket No. ER82-616, Tr. 2228. Thus, Opinion No. 234 focused on the disparities in installed nuclear investment costs which existed on the MSU System.

As indicated, the dissent found that the dispartiy in investment costs per megawatt of nuclear capacity among the MSU pool members had hardly changed as a result of the allocation ordered in Opinion No. 234 and, therefore, questioned whether the Commission's remedy resulted in undue discrimination. The dissent is correct in observing that the disparity among the MSU pool memers with respect to investment costs per megawatt of nuclear capacity was not substantially altered by Opinion No. 234. However, this measurement is not dispositive as to whether or not undue discrimination exists. In assessing whether undue discrimination existed as a result of the UPSA as filed and the 1982 System Agreement, and in adopting equalization of nuclear investment costs as the remedy, the Commission based its decision on megawatts of average *demand* placed on the Middle South pool by each of the four operating companies. *See* 31 FERC at pp. 61,655-56; 32 FERC at p. 61,960; 808 F.2d at 1558.

Allocation of the responsibility for the entirety of the MSU System's nuclear generating units' investment costs on the basis of the operating utilities' respective demands represents the application of a principle used in other contexts by the Commission. We have traditionally allocated investment costs on the basis of demand responsibility, i.e., the ratio of the purchaser's demand to the system's demand. *See, e.g., Wisconsin Michigan Power Co.*, Opinion No. 432, 31 FPC 1445 (1964); *Commonwealth Edison Co., 15 FERC* ¶ 63,048 (1981), *aff'd*, Opinion No. 165, 23 FERC ¶ 61,219 (1983);

Cities of Batavia et al. v. FERC, 672 F.2d 64, 80-83 (D.C. Cir. 1982); *Cities of Bethany et al. v. FERC*, 727 F.2d 1131, 1135-1137 (D.C. Cir. 1984); *Kansas Gas & Electric Co. v. FERC*, 758 F.2d 713, 714 (D.C. Cir. 1985); *Second Taxing District of Norwalk v. FERC*, 683 F.2d 477, 480 (D.C. Cir. 1982).

In contrast to the Commission's reliance upon megawatts of demand, the dissent to the court's January 6, 1987 opinion focused upon installed nuclear investment costs per megawatt of nuclear *capacity*. As discussed below, we do not believe this is the proper focus for assessing whether responsibility for nuclear investment costs on the MSU System has been allocated among the pool members so as to produce results which are just, reasonable, and non-discriminatory, or for allocating those costs.

At the outset, it is necessary to distinguish between capacity and demand. Capacity refers to the amount of total generation available to a utility. It is a measurement of capability. Demand, however, refers to the load actually placed on a system by its customers.

Principles of fairness in ratemaking support the concept that those who are responsible for the incurrence of costs be the ones who bear those cost burdens. Generating capacity is built in order to meet demand. Therefore, the cost of capacity should be allocated throughout an electric utility system in proportion to demand. *See Arizona Public Service Co.*, Opinion No. 177, 23 FERC ¶ 61,419, at p. 61,931 (1983). To the extent demand is met, it is a measure of benefit received by the purchaser. Therefore, any scheme to equalize investment costs should be based on megawatts (or kilowatts) of demand. A cost equalization approach that fails to consider demand would ignore the very determination that controls the need for various levels of capacity.

Analysis of the responsibility for System-wide nuclear investment costs on the basis of capacity, rather than on the basis of demand, does not establish whether the responsibility for such costs matches the burden which each operating company, and, in turn, its customers, places on the MSU pool. For example, if either of the two pool members which own no nuclear plants of their own (MP&L and NOPSI) is allocated one megawatt of Grand Gulf capacity, or it is allocated all of Grand Gulf capacity, its average installed nuclear investment cost per megawatt of nuclear capacity will be $2,222,222,[9] and this figure will not change regardless of the demand which that company places on the resources of the pool. Therefore, investment costs per megawatt of capacity is not a meaningful method for determining whether undue discrimination in the allocation of responsibility for nuclear investment costs exists. As a method for allocating costs, reliance upon investment costs per megawatt of capacity does not ensure that cost burdens are assigned on a predictable, uniform, and consistent basis — one which matches cost burdens with resposibility for those costs.

The results of the allocation chosen by the Commission in Opinion No. 234 are as follows:[10]

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[9]$ 2,500,000,000 / 1125 MW.

[10]Source. SERI. Initial Comments filed August 13, 1987, Appendix A. P. 1 (*See* Appendix A attached to this order).

Item	*AP&L*	*LP&L*	*NOPSI*	*MP&L*	*Total Pool*
Nuclear Costs per Megawatt of Average Demand ($ Thousands)	816	822	751	806	811
Percentage of Average Nuclear Cost per Megawatt of Average Demand	101%	101%	93%	99%	100%

The differences in nuclear cost per megawatt of demand for the four operating utilities are due to the use of rounded percentages in determining Grand Gulf allocations.[11]

In contrast, the UPSA as filed, in conjuntion with the System's investment in other nuclear plant, produced the following result:[12]

Item	*AP&L*	*LP&L*	*NOPSI*	*MP&L*	*Total Pool*
Nuclear Costs per Megawatt of Average Demand ($ Thousands)	412	1031	1316	772	811
Percentage of Average Nuclear Cost per Megawatt of Average Demand	51%	127%	162%	95%	100%

[11]I.e., the Commission and witness Louiselle, whose proposed allocation of Grand Gulf we adopted in Opinion No. 234, used Grand Gulf percentage allocations consisting of whole numbers (*e.g.*, 36%) rather than shares computed to several decimal places, which would result in each pool member's investment cost per megawatt of demand being identical.

[12]Source. SERI. Initial Comments filed August 13, 1987. Appendix A. p. 4. (*See* Appendix A attached to this order)

As the foregoing indicates, the allocation of Grand Gulf capacity ordered by the Commission in Opinion No. 234, while not significantly altering the disparity in nuclear investment cost per magawatt of nuclear *capacity* among the four operating companies, has virtually eliminated the disparity in nuclear investment costs per megawatt of average *demand*.

Our decision is consistent with the manner in which the MSU System has operated over the years. Although generation additions are planned primarily for the benefit of the MSU System as a whole, the System relied, prior to the formation of SERI, upon the process of rotating the responsibility for capacity additions among the individual pool members comprising the MSU System, which actually owned, constructed, and undertook the debt portion of the financing for the new facilities built. 26 FERC at pp. 65,098-101; 30 FERC at pp. 65,143-146; 808 F.2d at 1531, n. 12. the 1982 System Agreement provides that, for pricing purposes, the pool members have "first call" as to capacity and energy produced from the units which they own. None of the agreements pursuant to which the MSU pool members have conducted their integrated operations has explicitly provided for the complete equalization of all costs on the System. Nonetheless, over time, the rotational scheme, in conjunction with the terms of the 1951 and 1973 System agreements, resulted in a rough equalization of production costs among all of the individual members of the MSU pool. 30 FERC at p. 65,168; 26 FERC at p. 65,100; Docket No. ER82-616, Tr. 803, 2201; Docket No. ER82-483, Exh. La. PSC-1, p. 21. The pattern of rough equalization of production costs broke down, however, due to the problems the MSU System encountered in constructing nuclear generation. The allocation of Grand Gulf capacity which we ordered in Opinion No. 234, when coupled with the provisions of the 1982 System Agreement, will restore the pattern of rough equalization of production costs which had previously existed among the MSU

pool members, and it does so with as little disturbance to the manner in which the MSU System has conducted its integrated operations as is possible under the circumstances.

In sum, while the court is correct that we did not, in Opinion No. 234, set forth specific criteria for determining when undue discrimination exists, we believe that our Opinion did implicitly apply criteria that are firmly embedded in the factual setting of the two agreements we were reviewing. Explicitly stated, our criteria for determining when undue discrimination exists in this case were that each operating utility should contribute investments to meet the the capacity needs of the system in the long term, and that each operating utility should share in the overall capacity costs of the system in rough proportion to the benefits it receives (i.e., that its demand is met) from that system. Given the tremendous disparities in size and loads among the operating utilities, the only legitimate way to ensure that approximate parity between costs borne and benefits received is to ensure approximate equalization of cost responsibility on a per unit of demand basis. In other words, an allocation scheme that would not achieve a rough equalization of production costs on a demand basis would be, in the absence of a rational explanation, unduly discriminatory because there would be no basis for disparity among similarly situated entities. Hence, our criterion for determining undue discrimination in this context is derived from the factual setting of the principles underlying the complex agreements we were reviewing, not from more general notions of when undue discrimination occurs in regulated industries. However, as noted, this criterion is in conformity with a traditional Commission principle for allocating investment costs.

III

In addition to questioning the Commission's explanation as to why the remedy ordered in Opinion No. 234 was not unduly discriminatory, the dissent to the opinion of January 6, 1987, found that the explanation for our decision to include the installed capacity costs of all nuclear plants, rather than considering only the installed capacity costs of Grand Gulf and Waterford 3, or the installed capacity costs of all coal and nuclear plants, was not rational. Before responding to the points raised by the dissent, some preliminary comments are in order.

First, we note that no participant in Docket No. ER82-483 or ER82-616 advocated that the Commission equalize responsibility for the investment costs of either (1) Grand Gulf and Waterford 3 alone or (2) all coal and nuclear generation on the MSU System.[13] Rather, the criticisms of our decision to equalize responsibility for all nuclear investment costs set forth in the dissenting opinion were originally advanced by parties who support the allocation of Grand Gulf recommended by the presiding judge's initial decision in Docket No. ER82-483. That allocation, which simply assigned a pro rata share (based upon demand) of Grand Gulf capacity to each of the four MSU operating utilities, was based upon the finding that Grand Gulf was an anomaly to the regular manner in which generating facilities are planned and constructed on the MSU System. *See* 30 FERC at p. 65,172. We found in Opinion No.234, however, that Grand Gulf was planned and constructed in the same manner as all the other generating facilities on the System and, as a result, rejected the allocation recommended by the presiding judge in Docket No.ER82-483, 31 FERC at pp.

[13]The Commission's trial staff did advocate, however, that all coal and nuclear production costs, the capacity from those units, and the associated energy be equalized. This proposal is more comprehensive in scope than that suggested in the dissenting opinion.

61,651-4; our finding was affirmed by the court on appeal. 808 F.2d at 1555-1557.

Second, we reiterate that the overall production costs of all generation facilities other than nuclear were roughly comparable.

Third, we believe that it is important to remember that the "[a]llocation of costs is not a matter for the slide-rule. It involves judgment on a myriad of facts. It has no claim to an exact science." *Colorado Interstate Gas Co. v. FPC*, 324 U.S. 581, 589 (1945). Each of the proposals advanced by the participants in Docket Nos. ER82-483 and ER82-616 has its merits. None of the proposals is, as we indicated in Opinion No. 234-A, without its flaws. 31 FERC at p. 61,961. We do not claim that the remedy chosen in Opinion No. 234 is perfect, or that it is the *only* remedy which could reasonably have been chosen based upon the facts presented in the case. Rather, we believed then, and we continue to believe, that the allocation of Grand Gulf capacity so as to equalize responsibility for all nuclear investment on the MSU System (on a demand basis) is a reasonable result supported by the facts.

Our decision to equalize responsibility for the investment costs of all nuclear units (on a demand basis) was made in light of various considerations which are interrelated. The MSU utilities decided in the late 1960s to shift toward a new fuel base of coal and nuclear generation. As part of that goal, the MSU utilities envisioned that each of them would construct and own a nuclear plant in its own service territory. The System encountered various problems in seeking to carry out this plan. The cost of constructing nuclear generation escalated. MP&L, which was to own Grand Gulf Unit No. 1, was unable to finance the plant, and SERI was formed in order to do so. The responsibility for constructing Grand Gulf Unit No. 2 was shifted from NOPSI to MP&L due to siting problems. At present, construction of Grand Gulf Unit No. 2 has

been halted). In addition, the MSU System overestimated the need for additional capacity on the System and, as a result, has an abundance of reserves; 26 FERC at p. 65,102,30 FERC at pp. 65.144-146; at pp. 65,144-146; 31 FERC at pp. 61,654,655.

The effect of the events recited above was to create a large disparity in the share of nuclear investment costs borne by the MSU operating utilities (on a demand basis) and a resulting breakdown in the pattern of rough production cost equalization which had prevailed on the System among members of the pool. This disparity in nuclear investment costs is unjustified, in our view, since all the nuclear units were built primarily for the benefit of the System as a whole. Equalizing responsibility for all nuclear investment costs on a demand basis among the MSU pool members therefore serves, as previously stated, to remedy the undue discrimination in production costs which would otherwise exist on the pool. In addition, as noted in Opinion No. 234, our remedy is consistent with and serves to promote objectives set forth in the 1982 System Agreement such as equalizing imbalances of costs associated with facilities built for the mutual benefit of all the companies and the intent that each pool member have a share of nuclear generation, 31 FERC at pp. 61,654-57.

The dissent questioned our decision to equalize the installed capacity costs of all nuclear plants, rather then simply Grand Gulf and Waterford 3, since the cost overruns which occurred were unique to those two plants. While the escalations which occurred in the cost of constructing nuclear generation primarily affected Grand Gulf and Waterford 3,[14] and the total

[14]Although the ANO units did not suffer cost increases as enormous as those encountered in building Grand Gulf or Waterford 3, the effects of increases in the cost of constructing nuclear generation can be seen in the former units as well ANO 1 was installed in 1974 at a cost of

investment cost of those two plants is the cause of much of the MSU System's current difficulties, the result was to create a disparity in nuclear investment costs (on a demand basis) among the MSU pool members, which, in turn, disrupted the pattern of rough equalization of production costs. We do not find this disparity to be justified by factual circumstances. The fact that AP&L's ANO units cost less than Grand Gulf or Waterford 3 is due, as we previously found, simply to differences in timing as to when the units were built and by which company. 32 FERC at p. 61,961; Docket No. ER82-616, Tr. 461-62, 811-12, 940. The System decided that AP&L should build the first nuclear units because it was in the best interests of the System as a whole. Docket No. ER82-616, Tr. 462. Insofar as they were built for the benefit of the entire System, the ANO units stand on the same footing as the Grand Gulf and Waterford 3 units. Therefore, in order to restore the pattern of rough equalization of production costs, it is appropriate to focus on the total investment costs of *all* the nuclear plants built on the MSU System.

In addition, the dissent questioned our decision to equalize responsibility for installed nuclear capacity costs as opposed to the installed costs of both coal and nuclear plants. Since the installed costs of AP&L's ANO nuclear units were comparable to those of the coal-fired plants, and the Commission included the installed costs of the ANO units along with Grand Gulf and Waterford 3, then, the dissent suggested, the Commission should have included the installed costs of the MSU System's coal-fired units as well. However, as we explained in Opinion No. 234, the MSU System did not experience, in the case of coal-fired plants, the cost escalations that occur-

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approximately $276/kW ($276,000/MW), while ANO 2 was installed in 1980 at a cost of approximately $709/kW ($709,000/MW). Docket No. ER82-616, Tr. 894-6.

red with respect to nuclear generation. Docket No. ER82-616, Tr. 339-41, 800, 843-5.

We recognize, as did the dissenting opinion, that the ANO nuclear units are closer, in terms of installed investment costs and overall production costs, to the coal units than to the Grand Gulf and Waterford 3 units. Because the ANO units have characteristics of both the System's nuclear units—the same fuel source—and the cost units—comparable costs—Commission could have chosen to equalize the appropriate costs of a category of generation facilities more inclusive than nuclear. We believe that the decision to equalize the investment costs of all the MSU System's nuclear generation (on a demand basis) is reasonable in light of the facts that: (1) the MSU System encountered various difficulties in constructing nuclear units; (2) as a result, there exist disparities in nuclear investment costs per megawatt of demand which are unjustified by factual circumstances; and (3) the costs associated with non-nuclear generation on the integrated, MSU System were roughly comparable. In short, the unique nature of the problems associated with nuclear generation units provided the Commission with a rational reason for focusing upon that group of plants alone.

IV

In responding to our July 24 order, the commenters have raised a number of issues in their pleadings which were previously considered by the Commission in Opinion Nos. 234 and 234-A. Specifically, these issues include: the Commission's authority to reallocate Grand Gulf capacity; the integrated nature of the MSU System; and the use of updated cost figures for Grand Gulf and Waterford 3. Our decision, insofar as it resolved these points, was affirmed by the majority opinion of the three-judge panel. The dissenting opinion, in turn, did

not take issue with the majority as to its resolution of those points. They do not fall within the scope of the matters remanded to us by the court's June 24 order, and, therefore, we find no reason to address them in this Opinion. In addition, to the extent that our response to the court's remand covers arguments raised by the commenters, we rely upon the previous section of this Opinion.

Mississippi Industries request that we adopt a form of production cost equalization. Although our prior decision not to adopt production cost equalization was affirmed by the court's majority opinion, 808 F.2d at 1565-66, and that portion of the court's opinion was not vacated by the June 24 order, arguably we are free on remand to adopt such a remedy; if it is found necessary to alleviate undue discrimination. As we have stated elsewhere in this Opinion, the Commission could have chosen to equalize costs of more than just the nuclear plants. Because the problems on the MSU System were confined to nuclear plants. Because the problems on the MSU System were confined to nuclear generation, and equalization of nuclear investment costs alone on a demand basis will restore the balance of costs among the MSU pool members, we find it unnecessary to adopt a more comprehensive form of cost equalization.[15]

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[15]The Mississippi Commission, in its reply comments, recommends that Grand Gulf capacity be allocated so as to equalize responsibility for production costs directly, rather than "indirectly" via equalizing responsibility for nuclear investment costs. We find it unnecessary to adopt this remedy (which, we note, no participant proposed before either administrative law judge or the Commission in Docket Nos. ER82-483 and ER82-616). Equalization of nuclear investment costs alone on a demand basis will suffice to produce an allocation of costs which is not unduly discriminatory. Since production costs among the MSU pool members were never precisely equalized, we are not required to adopt a remedy which goes further than curing the undue discrimination which we found to exist. *See* 808 F.2d at 1566.

CNO *et al.* argue in support of the allocation recommended by Judge Head in Docket No. ER82-483. They contend that the propriety of that allocation is before the Commission on remand, in light of the fact that it was discussed in the portion of the majority opinion subsequently vacated by the court's June 24, 1987 order. The Louisiana parties dispute this, however. They note that, on April 3, 1987, the court granted rehearing ***en banc***, such rehearing limited to the issues raised by the dissenting opinion of January 6, 1987. *See* 814 F.2d 773. Following that order, the Louisiana parties moved that the court clarify its order granting rehearing ***en banc*** to state that it did not include consideration of Judge Head's allocation. By order dated May 19, 1987, the court ***en banc*** granted the motions, stating that the parties were to brief "only those issues addressed in the dissenting opinion . . . ." The court ***en banc***, therefore, did not, the Louisiana parties argue, intend to reconsider the propriety of Judge Head's allocation. Since the court remanded the case on July 24, 1987, for the reasons given by the dissenting opinion, it is alleged that the merits of that allocation and our decision to reject it are not within the scope of the remand. CNO *et al.*, in their reply, dispute these assertions.

Our reading of the court's July 24, 1987 order, in light of the events preeding its issuance, leads us to conclude that the propriety of our decision to reject the allocation recommended by Judge Head in Docket No. ER82-483 is not, as a result of that order, before us on remand. Nonetheless, as we indicated in connection with Mississippi Industries' proposed allocation, the Commission could, arguably, adopt Judge Head's allocation of Grand Gulf at this stage if necessary to remedy undue discrimination Therefore, we shall address the substantive arguments raised by CNO *et al.* in support of the allocation recommended by Judge Head.

In support of a pro rata allocation (based upon demand) of Grand Gulf, without regard to the pool members' prior investment in nuclear generation, CNO *et al.* argue that such an allocation: (1) results in similarly situated customers on the MSU System paying the same rate for Grand Gulf; (2) preserves rough cost equalization, citing MSS Exhibits 28 and 59 in Docket No. ER82-483; and (3) matches costs with benefits. In addition, CNO *et al.* argue that Grand Gulf was designed for the mutual benefit of all the operating companies, whereas the ANO units and Waterford 3 benefit only AP&L and LP&L, respectively. For the reasons which follow, we find these arguments to be unpersuasive and reject them.

With respect to the first point, the allocation chosen by the Commission in Opinion No. 234 will result in each operating company paying the same for each megawatt-hour of energy from the Grand Gulf plant. In fact, this is true of *any* allocation of Grand Gulf. This is because capacity and energy allotments from that plant are priced pursuant to a single, cost-of-service formula rate. At the wholesale level, there is no discrimination in the price of Grand Gulf capacity and energy.

As to the second point raised by CNO *et al.*, the cited exhibits are based upon the retail rates of the four operating companies, not production costs at the wholesale level. As we explained in Opinion No. 234-A, our decision does not result in the retail rates of the four operating companies being identical. This Commission does not have jurisdiction to set retail rates. Due to differing treatment of rate elements by the state regulatory authorities, retail rates among the MSU utilities will differ. 32 FERC at p. 61,959. The cited exhibits, therefore, do not indicate the effect of a pro rata allocation of Grand Gulf on costs relevant to this case.

The heart of CNO's claim, however, is the argument that its proposed allocation, unlike that chosen by the Commission,

matches costs with benefits. CNO *et al.* allege that the Opinion No. 234 allocation is flawed because, as a result, the proportion of System nuclear capacity to which each pool member is entitled does not match the proportion of total System nuclear investment costs for which each pool member is responsible. The Commission's failure to do so, it is alleged, produces the disparity in nuclear investment costs per megawatt of nuclear capacity noted by the dissenting opinion.

As discussed below, we disagree with CNO's view as to what constitutes, in this case, an appropriate "benefit." Nonetheless, we shall focus at this point upon the disparity in costs and capacity of which CNO *et al.* complain.

The disparity between costs and capacity arises because the Commission in Opinion No. 234 equalized total System nuclear investment dollars per megawatt of demand. As a result of our decision, each of the four MSU pool members bears a share of total System nuclear investment costs which is proportional to the demand that it places upon the pool. AP&L and LP&L had already assumed part of the burden of the System's investment in nuclear generation by paying for the ANO units and Waterford 3, respectively. If we were to disregard these contributions and simply give the four pool members pro rata shares of Grand Gulf capacity, AP&L and LP&L would have to carry a significantly disproportionate share of total nuclear investment on the MSU System.[16] The

[16]For example, under Judge Head's allocation which CNO *et al support*, LP&L would be allocated 44% of the $2.5 billion in projected Grand Gulf investment costs, or $1.1 billion. This allocation, added to the $2.1 billion in projected Waterford 3 investment costs, would make LP&L responsible for $3.2 billion, or 58% of the System's total nuclear investment, even though LP&L is responsible for only 44% of the System's load.

allocation chosen in Opinion No. 234 avoids this imbalance in the allocation of total System nuclear investment costs.

As stated, we chose to focus upon and equalize total System nuclear investment dollars per megawatt of demand in Opinion No. 234. Had we chosen to focus upon and equalize nuclear capacity instead, this would not eliminate the imbalance among the MSU pool members in the allocation of total System nuclear investment costs. We could also have chosen to equalize both total System nuclear nuclear investment dollars and nuclear capacity, by calculating an average system-wide cost per megawatt of nuclear capacity and allocating those average priced megawatts of nuclear capacity among the pool members based upon the demand each places upon the pool. Under this approach, however, each company would be responsible for the same number of dollars for nuclear investment on a demand basis that is produced by the Opinion No. 234 allocation. Moreover, there was no compelling reason to equalize nuclear capacity as well as nuclear investment dollars, since, in an operating sense, there is no shortage of capacity on the MSU System. Since costs are the ultimate burden on the System, and no need to equalize nuclear capacity exists, our decision to focus upon total System nuclear investment dollars per megawatt of demand is, we believe, a rational one

In any event, the allocation which CNO *et al.* advocate would not cure the disparity in costs and capacity, as the majority opinion originally recognized. *See* 808 F.2d at 1561-2, *reversed and vacated on other grounds*, 822 F.2d 1104. Allocating Grand Gulf capacity to the four operating companies on a *pro rata* basis, without regard to the companies' prior investment in nuclear generation, results in MP&L, for example, being responsible for 6.8% of System nuclear investment costs, but allocated only 4.3% of the System's nuclear capacity. In these circumstances, the argument that the opinion No. 234 alloca-

tion should be rejected in favor of the allocation recommended by the presiding judge in Docket No. ER82-483 because the former mismatches costs and capacity rings hollow.[17]

Finally, CNO *et al.*, argue that Grand Gulf differs from the other nuclear units in that it is only unit built for the mutual benefit of all the companies, whereas the ANO units and Waterford 3 were built to serve the needs only of AP&L and LP&L, respectively. CNO *et al.* also note that, pursuant to the terms of the 1982 System Agreement, AP&L and LP&L have first call on the capacity and energy from their respective nuclear units.

We considered and rejected CNO's arguments in Opinion Nos. 234 and 234-A in finding that the MSU System is an integrated system, and our finding was affirmed by the court. We see no reason, therefore, to respond to these arguments at this time, except for one matter. Underlying CNO's arguments is the notion that the only benefit provided by a generating unit is a direct entitlement to capacity from that unit. This premise is false. An important benefit from generating capacity is that demand is met. In addition, in the case of the centrally dispatched MSU System, all companies benefit from the greater diversity in System fuel mix which results from the existence of the nuclear units. Finally, as a result of constructing the System's generating facilities on an integrated basis, the System's members are able to achieve economies of scale in building new generation, reductions in reserve requirements, increased reliability, and efficiencies in operation. 26 FERC at p. 65,098, 30 FERC at p. 65,142, 31 FERC at pp. 61,646-48, *Arkansas Power & Light Co. v. FPC*, 368 F.2d 376 (8th Cir. 1966), *Electric Power & Light*

[17]CNO *et al.* also argue that the proper focus for assessing undue discrimination is nuclear investment costs per megawatt of nuclear capacity. For the reasons stated in Section II of this Opinion, that is erroneous.

Corp., 29 SEC 52, *aff'd*, 176 F.2d 687 (2nd Cir. 1949); *Middle South Utilities, Inc.*, 35 SEC 1 (1953). CNO's view as to what constitutes, in this case, a "benefit" is too narrow and, accordingly, must be rejected.

Therefore, upon reconsideration of the matters remanded to us by the court, and in light of the comments filed in response to our order of July 24, 1987, we shall, for the reason stated in Opinion Nos. 234 and 234-A, as clarified above, reaffirm the allocation of Grand Gulf capacity ordered in our prior Opinions.

The Commission orders:

(A) For the reasons stated in the Commission's Opinions issued on June 13, 1985, 31 FERC ¶ 61,305, and September 26, 1985, 32 FERC ¶ 61,425, as clarified in the body of this Opinion, the Commission hereby reaffirms and reinstates the orders issued in Opinion Nos. 234 and 234-A.

(B) Docket Nos. ER82-616-032 and ER82-483-028 are hereby terminated.

Appendix A

Table 1
Opinion No. 234
(Nuclear Investment Costs Used to Allocate Grand Gulf)

Item	*AP&L*	*LP&L*	*NOPSI*	*MP&L*	*Total Pool*
Pool Situs Nuclear Costs ($ Millions)	917.0	2058.9	0.0	0.0	2975.9
Grand Gulf Allocations	36%	14%	17%	33%	100%
Grand Gulf Investment Allocation ($ Millions)	900.0	350.0	425.0	825.9	2500.0
Total System Nuclear Investment Costs ($ Millions)	1817.0	2408.9	425.0	825.0	5475.9
Average Demand (Megawatts)	2226	2932	566	1024	6748
System Nuclear Investment Costs per Megawat of Average Demand	816	822	751	806	811
Percentage of Average System Nuclear Costs per Megawatt of Average Demand	101%	101%	93%	99%	100%

Sources Line 1—from Exh. 124, ER82-616
Line 2—from Opinion No 234
Line 3—Line 2 multiplied by $2500 million
Line 4—LIne 1 plus Line 3
Line 5—from Exh. 124, ER82-616
Line 6—LIne 4 divided by Line 5
Line 7—Line 6 divided by Line 6 "TOTAL POOL"

Table 2
UPSA as Filed

Item	*AP&L*	*LP&L*	*NOPSI*	*MP&L*	*Total Pool*
Pool Situs Nuclear Costs ($ Millions)	917.0	2058.9	0.0	0.0	2975.9
Grand Gulf Unit 1 Entitlement Percentaje	0.0%	38.57%	29.80%	31.63%	100%
Grand Gulf Allocated Investment ($ Million)	00.0	964.2	745.0	790.8	2500.0
Total Nuclear Investment Costs ($ Millions)	917.0	3023.1	745.0	790.8	5475.9
Average Demand (Megawatts)	2226	2932	566	1024	6748
Nuclear Investment Costs per Megawat of Average Demand	412	1031	1316	772	811
Percentage of Average System Nuclear Costs per Megawatt of Average Demand	51%	127%	162%	95%	100%

Sources Line 1—from Exh. 124, ER82-616
Line 2—from Exh. 7 ER82-616
Line 3—$2,500 million, multiplied by Line 2
Line 4—Line 1 plus Line 3
Line 5—from Exh. 124, ER82-616
Line 6—Line 4 divided by Line 5
Line 7—Line 6 divided by Line 6 "TOTAL POOL"

FEDERAL ENERGY REGULATORY COMMISSION

[¶ 61,091]

System Energy Resources, Inc., Docket No. ER82-616-035;
MSU System Services, Inc., Docket No. ER82-483-029

Opinion No. 292-A; Opinion and Order Denying Rehearing

(Issued January 29, 1988)

Before Commissioners: Martha O. Hesse, Chairman; Anthony G. Sousa, Charles G. Stalon, Charles A. Trabandt ad C.M. Naeve.

[Note: Opinion No. 292 on remand reaffirming prior allocation, issued November 30, 1987, appears at 41 FERC ¶ 61,238.]

[Opinion No. 292-A Text]

The Arkansas-Missouri parties[1] and the City of New Orleans, Louisiana (CNO), *et al.*[2] have filed requests for rehearing of Opinion No. 292, issued on November 30, 1987, 41 FERC ¶ 61,238. In Opinion No. 292 the Commission, following the court's decision in *Mississippi Industries v. FERC*, 822 F.2d 1104 (D.C. Cir. 1987), reaffirmed the allocation of capacity from the Grand Gulf Nuclear Generating Station Unit No. 1 (Grand Gulf) previously ordered in *Middle*

[1]The Arkansas Public Service Commission, the State of Arkansas, the Arkansas-Missouri Congressional Deleg..tion, the Missouri Public Service Commission, Reynolds Metals Company, Associated Industries of Arkansas, Riceland Foods, Inc., and Weyerhauser Company.

[2]The Mississippi Attorney General and the Mississippi Public Service Commission join in CNO's pleading.

South Energy, Inc., Opinion No. 234, 31 FERC ¶ 61,305, *reh'g denied*, Opinion No. 234-A, 32 FERC ¶ 61,425 (1985). That allocation was designed to equalize responsibility for installed nuclear investment costs among the members of the Middle South Utilities, Inc. (MSU) Pool.

The Arkansas-Missouri parties contend that the Commission's decision exceeded its authority under the Federal Power Act, unlawfully interferes with state regulatory authority, creates a "regulatory gap," and conflicts with the provisions of the Public Utility Holding Company Act of 1935.[3] Assuming *arguendo* that the Commission's decision was within its authority, the Arkansas-Missouri parties argue that none of the capacity from Grand Gulf should be allocated to Arkansas Power & Light Company (AP&L).

CNO *et al.* allege that the allocation chosen in Opinion Nos. 234 and 292 does not comply with the Federal Power Act's prohibition against undue discrimination and is inconsistent with the standard set forth and the Commission precedent cited in Opinion No. 292, the terms of the MSU System Agreement, and the historical operation of the System. CNO *et al.* also claim that the Commission has failed to justify its decision to equalize responsibility for the investment costs of all the nuclear generating plants, as opposed to either Grand Gulf and Waterford 3 or all of the System's coal and nuclear plants. They also complain about what they characterize as our decision not to allocate all nuclear capacity and energy on the MSU System along with nuclear investment cost responsibility. CNO *et al.* renew their request that the Commission allocate Grand Gulf capacity directly on the basis of the MSU Pool members' respective average demands, as recommended by the initial decision in Docket No. ER82-483. In support, they repeat their

[3] 15 U.S.C. §§ 79 *et seq* (1982).

claim that only Grand Gulf benefits all of the MSU operating companies, whereas the ANO and Waterford 3 nuclear units benefit AP&L and Louisiana Power & Light Company (LP&L), respectively.[4]

Discussion

The Arkansas-Missouri parties and CNO *et al.* have not raised any arguments which lead us to alter the decision reached in Opinion No. 292.[5] Some additional discussion is warranted, however, as to several points raised in the pleadings.

CNO *et al.* take issue with our reliance upon nuclear investment costs per megawatt of average demand as the criterion used for assessing whether undue discrimination exists and in remedying it. They claim that reliance upon demand is contrary to the premise that the MSU System continued to build nuclear generation in order to diversify the System's fuel mix, not in order to meet demand. They characterize the goal of fuel diversity as an energy-related one best measured by a "nuclear investment costs per megawatt of nuclear capacity" approach. In addition, CNO *et al.* allege that the Commission's standard ignores fuel cost savings because it erroneously assumes that each MSU pool member receives

[4]CNO *et al.* also note that, in Opinion No. 292, the Commission stated (at page 13) that its allocation was consistent with the MSU System Agreement's objective of equalizing imbalances in the costs of facilities built for the mutual benefit of the companies as CNO *et al.* correctly note, the System Agreement (at section 3.01) speaks of the equalization of the costs of facilities *used* for the mutual benefit of the companies.

[5]The Commission's jurisdiction in this proceeding to reallocate Grand Gulf capacity was previously affirmed, unanimously, by the court of appeals in its January 6, 1987 opinion and was not among the matters remanded by the court in its order of June 24, 1987. On December 14, 1987, the Supreme Court denied the petitions for certiorari in *Arkansas Public Service Commission et al. v. FERC*, Nos. 86-1380, 86-1424, and 87-469, in which the issue of the Commission's jurisdiction in this case was raised. We therefore consider the issue to be resolved with finality.

nuclear kilowatt-hours of energy in proportion to its share of average demand. This, CNO *et al.* state, is not the case because Mississippi Power & Light Company (MP&L) and New Orleans Public Service, Inc. (NOPSI) pay more , in percentage terms, of total System nuclear investment than they receive in terms of capacity and energy from the nuclear units.

CNO *et al.* are correct in asserting that the MSU System continued to build nuclear generation in order to diversify its fuel mix. However, this does not negate the facts that: (1) as we have previously found, Grand Gulf and the other nuclear units were originally planned in order to meet System demand as well as to diversify the System's fuel mix, 31 FERC at pp. 61,651-53; and (2) the nuclear units are, at present, operated to meet base load demand on the System. Moreover, the "nuclear investment costs per megawatt of average demand" standard does comport with the System's goal of diversifying its fuel mix via nuclear generation, since *average* demand reflects need for energy.

CNO *et al.* argue that, by focusing on and equalizing responsibility solely for nuclear investment costs per megawatt of average demand, we have ignored fuel savings accruing to AP&L in an amount they estimate at $160 million per year. In effect, CNO *et al.* contend that MP&L and NOPSI should receive more nuclear energy than they receive as a result of the Commission's Grand Gulf allocation. This is contradicted, however, by their support for the Grand Gulf allocation recommended by the initial decision in Docket No. ER82-483. That allocation would have awarded MP&L 15% of Grand Gulf and NOPSI 8%, based upon 1982 average loads. The Commission's alocation, on the other hand, awards MP&L 33% of Grand Gulf and NOPSI 17%. Clearly, our allocation gives MP&L and NOPSI access to *more* nuclear energy than does the allocation which CNO *et al.* advocate.

As to the $160 million figure cited by CNO *et al.*, its validity is open to question. CNO's calculations, for example, assume that nuclear energy, with fuel costs of approximately one cent per kilowatt-hour, replaces gas-fired energy with a fuel cost (based on 1931 prices) of five cents per kilowatt-hour.[6] However, CNO's argument ignores the existence of coal generation owned by AP&L. If AP&L were to give up nuclear energy to the other members of the MSU Pool, it may use that coal-fired generation, with a fuel cost of approximately two cents per kilowatt-hour.[7] to meet its needs, rather than gas-fired (or oil-fired) generation. Similarly, the receipt of additional nuclear energy by the other pool members may serve to displace energy from coal-fired generation which they receive under the System Agreement. Furthermore, CNO *et al.* do not take account of declines in the price of gas (or oil) which have occurred since 1981.[8] Any suggestion by CNO *et al.* that our allocation is unfair because it does not share with the other MSU pool members fuel savings of approximately $160 million accruing to AP&L is, in the circumstances, of dubious validity.

In any event, the allocation sought by CNO *et al.* would not result in each MSU pool member bearing the same nuclear investment cost per megawatt of nuclear capacity and, thus, would not comport with the standard which they advocate, because AP&L would still be entitled to the nuclear energy

[6]Comments of CNO *et al.* filed August 13, 1987, at 30-37.

[7]Docket No. ER82-616, Exh. 125.

[8]The Louisiana Public Service Commission calculates the amount of fuel savings which accrue to AP&L to be approximately $46 million Louisiana Public Service Commission, Motion for Clarification and Reaffirmation (filed July 22, 1987) at 29-30. In citing this figure, we make no finding as to the correct amount of the fuel savings. Our intent, rather, is simply to note the questionable nature of CNO's calculation.

from the relatively inexpensive ANO units. In addition, because AP&L remains entitled to the nuclear energy from the ANO units, adoption of the allocation recommended in the initial decision in Docket No. ER82-483 would still result in MP&L and NOPSI's contributing more, in percentage terms, to total System nuclear investment than the amount of System nuclear energy to which they take title.

CNO *et al.* also contend that the Commission erred in concluding that its allocation was consistent with the System Agreement and the historical operation of the System over the years. In support, they state that the agreement equalizes costs on the basis of entitlements to capacity and/or energy, not dollars per unit of average demand.

In stating that our allocation was consistent with the objectives of the 1982 System Agreement, we alluded to several provisions, among them section 3.01. That provision lists the objective of equalizing imbalances of costs of facilities used for the mutual benefit of the companies. Clearly, equalizing responsibility for the investment costs of the System's nuclear units, given that all of them were planned, built, and are operated primarily for the benefit of the System as a whole,[9] is consistent with this objective. We find no reason to alter our conclusion on this point. Insofar as CNO *et al.* attempt to link equalization of costs to direct entitlements to capacity and/or energy, this is not necessarily the case under the 1982 System Agreement. Rate Schedule MSS-1, contained in the agreement, provides for the equalization of reserves among "short" and "long" companies. This is done by comparing

[9]For example, section 30.02 in Rate Schedule MSS-3 (Exchange Energy) attached to the 1982 System Agreement states that System capability shall be operated to obtain the lowest reasonable cost of energy to *all* the companies consistent with the requirements of daily operating reserve, voltage control, electrical stability, loading of facilities, and continuity of service to the customers of each comp a ny.

the percentage share of *total* System capacity which each operating company owns or has available to it under contract with its percentage share of System demand. Reserve equalization payments are pegged to investment costs of the "long" company's intermediate (oil and gas) generating units. The equalization payment does not, however, give the "short" company and entitlement to the output from those oil and gas units.[10]

With respect to the statement that our remedy is consistent with the historical operation of the MSU System, the Commission was simply responding to the dissenting opinion's concern that the historical pattern of production cost equalization on the MSU System had not been maintained as a result of our allocation. CNO *et al.* confuse mechanisms in the 1982 System Agreement and its predecessors with the *effect* produced over time by those agreements.,

In light of the foregoing, we shall deny the requests for rehearing of Opinion No. 292.

The Commissionn orders:

(A) The requests by the Arkansas-Missouri parties and the City of New Orleans, Louisiana, *et al.* for rehearing of Opinion No. 292 are hereby denied.

(B) Docket Nos. ER82-616-035 and ER82--483-029 are hereby terminated. –

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[10]In addition, this demonstrates the fallacy of CNO's assertion that the only benefit from a generating unit is a direct entitlement to capacity and/or energy. Under CNO's approach, there would be no reason to have the reserve equalization mechanism in the System Agreement. Clearly, that document embodies a view that benefits other than direct entitlements to capacity and/or energy exist, as well as contradicting the thrust of CNO's assertion that the percentage of costs borne must be precisely the same as that of the benefits, in the form of direct entitlements to capacity and/or energy.

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United States Court of Appeals

FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1611

MISSISSIPPI INDUSTRIES, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION, RESPONDENT

[Captions for cases Nos. 85-1613, 85-1620 & 85-1621; 85-1615; 85-1616; 85-1617; 85-1618; 85-1619; 85-1623, and 85-1624 omitted in printing.]

Petitions for Review of Orders of the
Federal Energy Regulatory Commission

Argued March 24, 1986

Decided January 6, 1987

James P. Murphy, with whom *Michael T. Mishkin*, *James V. Selna*, *Donald T. Bliss*, and *David T. Beddow* were on the brief, for petitioner Arkansas Industries.

Bills of costs must be filed within 14 days after entry of judgment. The court looks with disfavor upon motions to file bills of costs out of time.

Carl D. Hobelman, with whom *Jerry D. Jackson*, *M. Remy Ancarrow*, and *Robert J. Glasser* were on the brief, for petitioner Arkansas Power & Light Company.

J. Cathy Lichtenberg, with whom *Wallace L. Duncan*, *James D. Pembroke*, *Janice L. Lower*, *Martin C. Rothfelder*, *William Massey*, *Steve Clark*, and *Mary B. Stallcup* were on the brief, for petitioners Arkansas Public Service Commission, *et al.*

Hiram C. Eastland, Jr., with whom *Edwin L. Pittman*, *Frank Spencer*, *John L. Maxey, II*, and *Alfred Chaplin* were on the brief, for petitioners Mississippi Public Service Commission, *et al.*

James K. Child, Jr., with whom *Paul H. Keck*, *Michael F. Healy*, *Douglas L. Beresford*, *Robert R. Nordhaus*, *Adam Wenner*, *Howard Eliot Shapiro*, and *Margaret A. Moore* were on the brief, for petitioners Mississippi Industries, *et al.*

Glenn L. Ortman, with whom *Clinton A. Vince* and *Paul E. Nordstrom* were on the brief, for petitioner City of New Orleans.

Michael R. Fontham, with whom *David B. Robinson* and *Paul L. Zimmering* were on the brief, for petitioner Louisiana Public Service Commission.

Peter C. Kissel, *Richard G. Morgan*, *Earle H. O'Donnell*, and *Robert R. Morrow* were on the brief for petitioners Occidential Chemical Corporation, *et al.*

A. Karen Hill, Attorney, Federal Energy Regulatory Commission, with whom *William H. Satterfield*, General Counsel, *Jerome M. Feit*, Solicitor, and *John N. Esler, III*, Attorney, Federal Energy Regulatory Commission, were on the brief, for respondent.

Richard M. Merriman, *Robert S. Waters*, and *James K. Mitchell* were on the brief for intervenors Middle South Services, Inc., *et al.*

William A. Chesnutt entered an appearance for intervenor Union Carbide Corporation.

Before EDWARDS and BORK, *Circuit Judges*, and WRIGHT, *Senior Circuit Judge*.

Opinion *per curiam*.

Separate opinion by *Circuit Judge* BORK, concurring in part and dissenting in part.

PER CURIAM: We consider eighteen consolidated petitions for review of two orders of the Federal Energy Regulatory Commission (FERC or the Commission).[1] In the orders under review the Commission held that the four operating companies of the Middle South Utilities (MSU) system must share the costs of MSU's investment in nuclear energy in proportion to their relative demand for energy generated by the system as a whole. The Commission implemented this scheme by reallocating responsibility for investment costs associated with the catastrophically uneconomical Grand Gulf I nuclear plant. The parties attack both the Commission's jurisdiction and the rationality of its decision. Although the Commission's allocation of nuclear investment costs is subject to reasonable dispute, we do not think such criticisms warrant reversal of FERC's orders. We therefore affirm.

I. BACKGROUND

The controversy facing the court today stems from the pattern of power generation investment cost sharing practiced by Middle South Utilities and its operating companies. In order to address fully the proper allocation of the costs of nuclear power generation among those companies, we review MSU's structure, the history of its involvement in nuclear power generation, and the record of the proceedings below.

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[1] *Middle South Energy, Inc. and Middle South Services, Inc.*, 31 FERC ¶ 61,305 (1985), and *Middle South Energy, Inc. and Middle South Services, Inc.*, 32 FERC ¶ 61,425 (1985) (opinion on rehearing).

A. *The Middle South System*

1. *Corporate structure.* Middle South Utilities, Inc. is a registered holding company under the Public Utility Holding Company Act of 1935 (PUHCA). 15 U.S.C. § 79 *et seq.* (1982). It owns outright four utility operating companies: Louisiana Power & Light Co. (LP&L), New Orleans Public Service, Inc. (NOPSI), Arkansas Power & Light Co. (AP&L), and Mississippi Power & Light Co. (MP&L). *See Middle South Energy, Inc.*, 26 FERC ¶ 63,044, 65,098 (1984). The operating companies sell electricity, both wholesale and retail, in the states of Louisiana, Arkansas, Missouri, and Mississippi.[2]

Although each operating company has a separate board of directors, the sole stockholder, MSU, selects each director. In addition, the various companies do have common or overlapping officers and directors. The Chairman and Chief Executive Officer (CEO) of MSU is a member of the board of each operating company and the CEOs of the operating companies are members of the board of MSU. Other MSU board members are also board members of individual operating companies. *Middle South Services, Inc.*, 30 FERC ¶ 63,030, 65,142 (Docket No. ER82-463-000) (ALJ Head).

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[2] MSU also owns a corporate services company, Middle South Services, Inc., and a fuel purchasing company, System Fuel, Inc. *See Middle South Services, Inc.*, ER82-483-000, 30 FERC ¶ 63,030, 65,141-42 (1985).

One useful way of viewing the relative size of the companies is to compare their relative shares of the system's average demand:

	Share of Total System Load
LP&L	44%
AP&L	33%
MP&L	15%
NOPSI	8%

See Middle South Energy, Inc., ER82-616-000, 26 FERC ¶ 63,044, 65,109 (1984). These figures are based on average load demand in 1982.

Transactions among the various operating companies are governed by a System Agreement. Over its history, MSU has filed three successive System Agreements—in 1951, 1973, and 1982. The Commission scrutinizes the System Agreement and modifies it when necessary. *See, e.g., Middle South Services, Inc.*, 16 FERC ¶ 61,101 (1981) (modifying the 1973 System Agreement), *aff'd*, 688 F.2d 357 (5th Cir. 1982), *cert. denied*, 460 U.S. 1082 (1983). Section 3.01 of the Agreement states the system's general goal of operating as a coherent unit:

> The purpose of this Agreement is to provide the contractual basis for the continued planning, construction, and operation of the electric generation * * * facilities of the Companies in such a manner as to achieve economies consistent with the highest practicable reliability of service * * *. This agreement also provides a basis for equalizing among the Companies any imbalance of cost associated with the construction, ownership and operation of such facilities as are used for the mutual benefit of all the Companies.

483-R. 7117, VII Joint Appendix (JA) 1569.[3] In light of this language, Administrative Law Judge (ALJ) Head found that the MSU system has sought to coordinate the addition of operating capacity by each individual operating company while achieving the greatest economies of scale.[4] As he observed:

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[3] Citations to the record in *Middle South Services, Inc.*, ER82-483-000, 30 FERC ¶ 63,030 (1985), are noted as "483-R." Citations to the record in *Middle South Energy, Inc.*, ER82-616-000, 26 FERC ¶ 63,044 (1984), are noted as "616-R."

[4] Specifically, ALJ Head found:

> Article III of the Agreement provides, *inter alia*, for planning, construction and operation of both power supply and related facilities on a coordinated basis (Section 3.02); for moving toward a new fuel base of coal and nuclear to minimize costs and reduce dependence on gas

> The System Agreements * * * clearly permit and encourage, for efficiency, reliability, and other economies of scale, that the individual companies from time to time build larger facilities than are necessary to meet their own native load, to benefit all the generating companies by having lower costs and greater reliability. * * *

30 FERC at 65,142.

All three System Agreements have assigned the task of coordinating the planning of new generating capacity to a systemwide Operating Committee.[5] The CEO of each operating company designates one member of the committee, as does MSU. The members representing the operating companies control 80% of the votes on the committee, apportioned according to each individual company's share of the system's investment in generating capacity. The representative of MSU votes the remaining 20%. Under Section 5.04 of the System Agreement, the Operating Committee can now take action on the basis of a bare majority. 483-R. 7129, VII JA 1581.

2. *Investment cost sharing.* As ALJ Liebman noted, the MSU system planning approach to new generating capacity inevitably results in certain operating companies having less generating capacity than do others for varying periods of time. *See* 26 FERC at 65,098 (Docket No.

> and oil (Section 3.03); for a long-term goal of each company having a proportionate share of coal and nuclear units available to serve its customers * * *; and for joint planning on a system-wide basis for construction and operation of major facilities to achieve economies of scale associated with construction and operation of larger generating units * * * (Section 3.08).

30 FERC at 65,122.

[5] Thus under § 5.06(c) of the 1982 System Agreement the Operating Committee is responsible for, *inter alia*, determining the amount of reserve capacity on the system and requiring the installation of that capacity. *See* 483-R. 7130, VII JA 1582.

ER82-616-000). If a company does not have enough capacity to meet the needs of its consumers, the deficient operating company can always draw on the excess capacity of the other companies on the system.[6] This system also benefits those companies that have built more capacity than necessary to meet current demand. Such companies generally find willing buyers of their surplus among the other companies on the system.[7]

Under the system planning approach, it is inevitable that an operating company will, from time to time, provide a proportionate share of the system's investment in generating capacity that is more or less than its proportionate demand for the system's energy. If a company's share of the system's generating *capacity* is greater than its share of the *energy* actually generated and distributed by the system as a whole, the company is deemed to be "long." If the company's share of the system's generating capacity is *less* than its percentage of the system's energy, the company is deemed "short." 26 FERC at 65,099.[8]

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[6] For example, in the 1960's and 1970's AP&L almost never had enough capacity to service its native load, and frequently drew on LP&L's capacity to make up the deficiency. 26 FERC at 65,098-99.

[7] All energy on the system is dispatched from a central office in Pine Bluff, Arkansas. 30 FERC at 65,142. The System Agreement establishes a schedule called MSS-3 setting rates for the purchase of energy from the system pool. When a company needs energy it is billed for the lowest cost energy available in the pool. Companies owning the capacity that generates such low cost energy have first claim to that energy. 483-R. 7151, VII JA 1603. When a company needs more energy than its native capacity can produce it therefore must stand in line behind the other companies for access to the relatively cheapest kilowatts.

[8] The terms "long" and "short" do *not* refer to a company's ability to provide enough energy to meet its customers' requirements. Instead, they reflect a comparison of the share of system capacity contributed by a particular company with the share of the system's energy utilized by that company. It is entirely possible that a company could be "short" and

Since 1951 the MSU system has sought to iron out the inequities that would otherwise result where some companies were long while other companies were short through a system of "equalization payments." Prior to 1973 each "short" company made a payment to the "long" companies based on a fixed dollar amount per kilowatt of capacity that the company was short.[9] In 1973 the System Agreement was amended to provide for capacity equalization payments calculated under the "participation unit" formula, a formula that based payments on the ownership costs of the latest unit constructed by the "long" company.[10] *See id.*; *see also* 30 FERC at 65,122-23.

Importantly, this new system did *not* call for equalization payments based on the relative number of *dollars* each company had invested in generating capacity. Instead, the relative number of *kilowatts* of generating capacity owned by each company formed the basis for the payments. Because kilowatts can vary in cost, the system potentially perpetuated the operating companies' relatively unequal investment in generating capacity.

For over twenty-five years, however, the system largely avoided this potential inequity. Notwithstanding its limitations, the equalization payment approach managed to produce the *effect* of roughly equalizing the cost of investing in new capacity from the 1950's through the 1970's. During the years in which the 1951 System Agreement was in force the cost of creating such capacity was relatively uniform and relatively-constant. *See* 616-R. 1332-

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still have more than enough capacity to meet its own needs. 26 FERC at 65,099.

[9] Specifically, the 1951 System Agreement provided for a monthly payment of $1.10 per kilowatt by which a company was "short." *See* 483-R. 7398, VII JA 1786.

[10] This approach also provided for the "short" company receiving an entitlement to a proportionate share of the energy generated by the "participation unit." 26 FERC at 65,099.

33, I JA 140-41; 30 FERC at 65,168.[11] As a consequence, the System Agreement's allocation of equalization payments based on a constant dollar per kilowatt of short capacity served to equalize investment costs. Although in the 1970's the cost of new units began to exceed that of older facilities by a substantial margin, the 1973 System Agreement balanced this development by basing equalization payments on the costs of the newest (and more expensive) units of the "long" companies. 26 FERC at 65,100.[12]

3. *The shift to nuclear energy and its consequences.* In the 1950's and 1960's the MSU system tended to add new generating units in the southern part of the system to take advantage of cheap oil and gas reserves in Louisiana. *See* 26 FERC at 65,100; 30 FERC at 65,143. In the late 1960's, however, the system began a program of adding coal and nuclear generating capacity, 30 FERC at 65,144, that eventually resulted in the collapse of the investment equalization program.

AP&L was the first operating company to make such an investment in nuclear power. AP&L had historically been both a short company and one with insufficient capacity to meet the requirements of its customers. 30 FERC at 65,143. Moreover, AP&L had been losing its long-term gas contracts while Louisiana and Mississippi continued to have an adequate supply of gas and oil. 26 FERC at 65,101. In December 1974 AP&L brought on

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[11] *See also* 30 FERC at 65,143-44 (indicating that the units added in the 1960's and early 1970's were priced between $58 and $97 per kilowatt).

[12] ALJ Liebman also credited testimony indicating that two other factors promoted equalization of overall generation costs. First, responsibility for adding new capacity generally rotated among the operating companies, evening out investment costs over time. Second, the burden borne by companies adding relatively more expensive new capacity was often offset by the lower fuel costs associated with such units. *See* 26 FERC at 65,100.

line MSU's first nuclear plant, Arkansas Nuclear One (ANO) Unit 1.

Although ANO 1's capacity was substantially more expensive than that of non-nuclear generating units built at the time,[13] 26 FERC at 65,100-01, the lower fuel costs of a nuclear unit made the *total* generation costs of ANO 1 comparable to those of other plants brought on line in the 1970's.[14] Thus it is fair to say that the basic system of roughly equalizing the costs and benefits derived from the system's investment in new capacity remained intact.[15]

The picture changed radically with the development of two new nuclear units—the Waterford 3 unit (assigned to LP&L) and Grand Gulf 1 (initially assigned to MP&L). Grand Gulf was initially projected to cost $1.2 billion for two generating units.[16] Regulatory delays, additional construction requirements, and severe inflation ran up Grand Gulf costs to in excess of $3 billion for one unit.[17] Similar cost over-runs marred the construc-

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[13] Capacity cost of ANO 1 was $276 per kilowatt, nearly double that of the oil-fired units introduced by MP&L and LP&L during the same period. 26 FERC at 65,101; 30 FERC at 65,144.

[14] 30 FERC at 65,144. The initial cost was about 3 cents per kilowatt hour. 26 FERC at 65,101.

[15] Nor did this basic pattern change substantially with the introduction of ANO 2 in 1980. Although ANO 2 had cost substantially more per kilowatt than did ANO 1, AP&L's *total* nuclear capacity is still quite reasonably priced at $500 per kilowatt or 3-4 cents per kilowatt hour. *See* 30 FERC at 65,145.

[16] Grand Gulf, for example, was originally projected to come on line at a cost of approximately $500 per kilowatt, a price comparable to that of the average price per kilowatt of the two ANO units. 26 FERC at 65,103.

[17] This figure was presented in the Commission's initial opinion. 31 FERC at 61,632. In determining the allocation

tion of Waterford 3. *See Middle South Energy, Inc. and Middle South Services, Inc.*, 31 FERC ¶ 61,305, 61,654 (1985). These units produce the most expensive energy on the MSU system. Measured in dollars per kilowatt of generating capacity, the new units were five times costlier than the ANO units installed by AP&L.[18] Most important, although these two plants have been estimated to represent over 70% of the production costs of the MSU system, they apparently will produce only 13% of the electricity used on the system. 30 FERC at 65,121.

Under these conditions, continued application of a capacity equalization scheme that only sought to equalize *kilowatts* could no longer come close to equalizing investment *dollars*. Any operating company saddled with re-

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of Grand Gulf capacity the Commission adopted the figures used by ALJ Liebman in his initial decision. *Id.* at 61,657. ALJ Liebman relied on the following cost estimates: $2.5 billion for Grand Gulf 1 and $2.4 billion for Waterford 3. *See* 26 FERC at 65,107. These figures represent the cost of these units as of December 31, 1981, rather than on the date of commercial operation (which was several years later). Thus ALJ Liebman conceded that the projected cost of Grand Gulf 1, as of 1984, was $2.8 billion. *See id.*

ALJ Head relied on a different, higher, and presumably more recent, set of figures. His conclusion that the new nuclear units would cost approximately $2,500 per kilowatt, 30 FERC at 65,121, was based on the testimony offered by Mr. Louiselle, a witness for LPSC, who, in the portion of the transcript cited by the ALJ, assumed that MSE's 90% share of Grand Gulf 1 would cost $2.92 billion and Waterford 3 would cost about $2.76 billion. *See* 483-R. 4124-26, VI JA 1452.

[18] ALJ Head estimated that Grand Gulf 1 and Waterford 3 would come on line at a cost of $2,500 per kilowatt. By contrast, he found that the two ANO units came on line at a cost of about $500 per kilowatt. 30 FERC at 65,121. ALJ Liebman estimated that Grand Gulf 1 would come on line at a cost three to four times greater than that of any unit already on the MSU system. *Id.* at 65,103.

sponsibility for Waterford 3 and/or Grand Gulf would likely find itself paying far more per kilowatt of capacity than would an operating company that was free of such a burden. 26 FERC at 65,100.

It is true that MSU filed a new System Agreement in 1982 altering its previous equalization scheme. Unlike the 1973 Agreement, which had pegged equalization payments to the cost of the long company's most recent generating addition, the 1982 Agreement provided for equalization payments based on the long company's "intermediate" (*i.e.*, oil and gas) units. 483-R. 7137-50, VII JA 1589-96. This change reduced the burden on any company that might be *both* short and have substantial responsibility for the new nuclear plants.[19] But, as discussed below, this change did not eliminate the major inequities that nuclear power introduced to the MSU system.[20]

4. *The Grand Gulf plant.* The Grand Gulf project was initiated by MSU to meet the then projected demand for electricity by the *system as a whole.* 26 FERC at 65,101-02. By the late 1970's, however, it became clear that projected demand would fall well short of previous expectations.[21] Nonetheless, MSU continued to build Grand Gulf 1 [22] on the assumption that the overall cost per

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[19] On the other hand, the new agreement did not provide for an entitlement to the "intermediate" kilowatts of energy produced by the long company. Thus the short company might still have to purchase expensive nuclear energy whenever it lacked the capacity to meet its native load. 30 FERC at 65,140.

[20] Moreover, the new equalization scheme actually made matters worse for any company that was both *long* and retained substantial responsibility for one of the new plants.

[21] Indeed, as ALJ Head observed, the entire MSU system now has much more capacity than it needs. 30 FERC at 65,169.

[22] MSU, however, did halt construction of the second unit in the project, Grand Gulf 2. 31 FERC at 61,668 n.2. The Commission therefore did not decide on the allocation of

kilowatt hour would be less than that of alternative energy sources. 26 FERC at 65,102.[23]

Initially the plant had been assigned to MP&L.[24] It soon became apparent, however, that MP&L did not have the resources to finance the construction of the plant. As a consequence, MSU made a system decision to form Middle South Energy (MSE) in 1974 as a vehicle for financing Grand Gulf. MSE acquired full title to Grand Gulf. In June of 1974 all four Middle South operating companies entered into an "Availability Agreement" under which each operating company put its credit behind Grand Gulf.

Notwithstanding this initial agreement, at the time MSE was first formed no clear plan existed to allocate responsibility for Grand Gulf's capacity to each of the companies. Over the years various allocation plans were put forward, ultimately resulting in the Unit Power Sales Agreement (UPSA) at issue in this case.

Grand Gulf 2 costs, finding that issue to be purely speculative at this time. *Id.* at 61,669 n.20.

[23] This assumption is now questionable. Through the 1990's Grand Gulf will *not* produce energy that is cheaper than energy produced from alternative sources. Indeed, ALJ Liebman estimated that by 1993 ratepayers will pay $3 billion more for Grand Gulf energy than they would for energy from comparable sources. As of 1984 MSU was still predicting that Grand Gulf power would become economical at some future date and that at some (even later) point the project will represent a net benefit to consumers. 26 FERC at 65,103. As ALJ Liebman noted, however, the decline in the price of oil makes these projections appear rather dubious. *Id.*

[24] Grand Gulf is located in Port Gibson, Mississippi. Under the original plan each operating company in the system would be responsible for the financing and construction of a major nuclear facility. It was soon determined, however, that the site for the NOPSI plant near New Orleans was unsuitable; that unit was transferred to Mississippi. Responsibility for construction of both units shifted to MP&L. 26 FERC at 65,102.

At first it was contemplated that MSE would become a party to the System Agreement. Under this plan all of Grand Gulf would be a "participation unit" and responsibility for the plant's capacity would shift among the operating companies to the degree they were short. 616-R. 4122-23, II JA 505.

In 1979 MSU officials, having come to the conclusion that a fixed allocation of capacity was preferable to a scheme of shifting responsibilities, recommended a plan that would have allocated a share of Grand Gulf capacity to all of the operating companies.[25] But by early 1980 the MSU officers were moving toward a scheme absolving AP&L of all responsibility for Grand Gulf. In July of 1980 the CEOs of the MSU operating companies signed a Memorandum of Understanding, freeing AP&L of all responsibility for Grand Gulf. Although this Memorandum was never submitted to the Coordinating Committee, and therefore never became final, its basic terms were set forth in a "Reallocation Agreement" executed in July 1981. 616-R. 3275, I JA 268. Under the Reallocation Agreement AP&L assigned its entitlement to purchase Grand Gulf power to the other companies.[26] In addition,

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[25] In 1979 the Operating Committee of the MSU system recommended "Plan 4A" under which the operating companies would have the following responsibilities:

Company	Percentage
AP&L	11.11
LP&L	13.51
MP&L	49.60
NOPSI	25.78

26 FERC at 65,102. Although "Plan 4A" was tentatively approved by the MSU Board of Directors in November of 1979, the Board soon retreated from this position and, in January of 1980, approved an allocation plan quite similar to the UPSA. *Id.* at 65,103.

[26] In 1981 AP&L's share of Grand Gulf power under the Availability Agreement was calculated to be 17.1%, with

NOPSI, LP&L, and MP&L agreed to indemnify AP&L for any obligation it might incur to MSE's creditors. The Reallocation Agreement thus relieved AP&L of any responsibility for Grand Gulf capacity costs and provided the basis for the Unit Power Sales Agreement. 26 FERC at 65,103.

The Unit Power Sales Agreement was executed on June 10, 1982. Although all of the operating companies are signatories to the UPSA, it only provides for sale of Grand Gulf capacity and energy by MSE to three of the operating companies: LP&L, MP&L, and NOPSI, but *not* to AP&L. 26 FERC at 65,095.[27]

B. *The Proceedings Below*

In April 1982 MSU filed with the Commission the 1982 System Agreement, which set the general rules governing transactions between the operating companies, including capacity equalization payments and the rates governing the exchange of energy between the operating companies. FERC set the proceeding for hearing before ALJ Head. In June 1982 MSU filed the Unit Power Sales Agreement with the Commission, governing the sales of Grand Gulf capacity and energy by MSE to the four operating companies. This proceeding was set for hearing before ALJ Liebman.[28] ALJ Liebman issued his opinion

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LP&L responsible for 26.9%, MP&L responsible for 31.3%, and NOPSI responsible for 24.7%. 26 FERC at 65,102.

[27] UPSA assigns LP&L the entitlement to purchase 38.57% of the power available to MSE from Grand Gulf, MP&L 31.63%, and NOPSI 29.80%. 26 FERC at 65,097 (excluding Unit 2 percentages). MSE only owns 90% of Grand Gulf; 10% has been sold to South Mississippi Electric Power Association. *Id.* These figures therefore only refer to percentages of MSE's share of the Grand Gulf facility.

[28] By order issued August 25, 1982 the Commission accepted the UPSA for filing but found that it constituted a rate change rather than an initial rate filing; FERC therefore

on February 3, 1984, *Middle South Energy, Inc.*, 26 FERC ¶ 63,044 (1984), and ALJ Head issued his opinion a year later, on February 4, 1985. *Middle South Services, Inc.*, 30 FERC ¶ 63,030 (1985). Both decisions touched on the allocation of Grand Gulf power, and FERC reviewed both decisions in an opinion issued June 13, 1985. *Middle South Energy, Inc. and Middle South Services, Inc.*, 31 FERC ¶ 61,305 (1985). It revisited the issue following petitions for rehearing in an opinion issued September 28, 1985. *Middle South Energy, Inc. and Middle South Services, Inc.*, 32 FERC ¶ 61,425 (1985).

1. *ALJ Liebman's decision in the UPSA case (ER82-616).* The principal issue [29] in ER82-616 was whether the UPSA's proposed allocation of Grand Gulf invest-

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suspended the rates which were to become effective under the UPSA, subject to refund. *See Middle South Energy, Inc.*, 20 FERC ¶ 61,206 (1982). On May 24, 1983 the Commission recharacterized the UPSA as an initial rate, but held that it had the authority to suspend initial rates. *Middle South Energy, Inc.*, 23 FERC ¶ 61,277 (1983). In *Middle South Energy, Inc. v. FERC*, 747 F.2d 763, 772 (D.C. Cir. 1984), this court reversed the Commission, holding that the Federal Power Act only permits suspension of changed rates.

On remand FERC determined that the Sales Agreement rates were changed rates after all, giving it authority to suspend them subject to refund. That decision was appealed to this court, but the appeal has been held in abeyance pending the outcome of this case. *See Arkansas Power & Light Co. v. FERC*, No. 85-1504 (D.C. Cir., filed Aug. 14, 1985). As matters stand, the rates filed in the UPSA were never suspended because FERC issued its final decision in Order No. 234, amending the UPSA, before service from Grand Gulf commenced. As we uphold FERC's decision here, the question whether the rates filed in the UPSA are subject to the suspension power of the Commission is now moot.

[29] ALJ Liebman, ALJ Head, and the Commission all addressed myriad issues that are not presented in the petitions before this court. These issues are not discussed in this opinion.

ment costs was reasonable and, if not, how such costs should be allocated. As a threshold matter, however, ALJ Liebman rejected a series of arguments suggesting that FERC did not have jurisdiction or statutory authority to amend this aspect of the UPSA.[30]

Having found jurisdiction, ALJ Liebman found that the UPSA was "unduly discriminatory" under Section 206(a) of the Federal Power Act, 16 U.S.C. § 824e(a) (1982),[31] because it failed to allocate any portion of Grand Gulf's capacity costs to AP&L. He based this decision on his view of the MSU system as a highly integrated operation that made critical decisions—such as the decision to move into nuclear power—as a unit. Under that view ALJ Liebman thought it only fair that AP&L pay its share of the company's decision to build nuclear capacity. Having rejected the UPSA's allocation of Grand Gulf costs, ALJ Liebman was faced with three alternatives:

> (1) Making Grand Gulf a participation unit, with floating responsibility among the short(er) companies.[32]
>
> (2) Allocating responsibility for Grand Gulf capacity proportionate to each operating company's relative share of system demand, as fixed in 1982.[33]

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[30] He rejected, *inter alia*, the following arguments: (1) the reallocation of Grand Gulf costs violated the *Mobile-Sierra* doctrine, 26 FERC at 65,113-16; (2) the reallocation constituted a forced purchase of power barred by the Act, *id.* at 65,115-17; and (3) the PUHCA gives the Securities and Exchange Commission primary authority over the allocation of Grand Gulf costs, *id.* at 65,117.

[31] Section 205(b), 16 U.S.C. § 824d(b) (1982), similarly bars any "undue preference" in wholesale rates.

[32] This proposal was put forth by the Mississippi Public Service Commission.

[33] This proposal was put forward by the City of New Orleans. On appeal CNO has abandoned this view and adopted

(3) Allocating responsibility for Grand Gulf such that each operating company bore a share of the cost of *all* the nuclear units on the MSU system proportionate to that company's relative share of system demand, as fixed in 1982.[34]

26 FERC at 65,109.

ALJ Liebman chose the last proposal. As the Commission noted, this approach did not merely allocate the cost of Grand Gulf. By including the total system investment in nuclear power in his formula, ALJ Liebman effectively reallocated the costs of all nuclear capacity on the MSU system. 31 FERC at 61,633.

ALJ Liebman justified his exclusive focus on nuclear capacity costs—rather than on equalizing the costs of all

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that of ALJ Head, *i.e.*, the allocation of Grand Gulf capacity alone—and not that of all nuclear plants—but calculating that allocation on the basis of each company's relative demand for system load in any particular year. *See* Brief of Petitioner City of New Orleans, Louisiana at 48.

[34] This proposal was originally put forward by the Louisiana Public Service Commission and Occidental Chemical Corporation. As the Commission suggested, this alternative can be broken down into the following three-step process:

(1) *Calculating each company's nuclear responsibility ratio.* This ratio consists of each operating company's 1982 share of the system's total demand over the entire system's demand.

(2) *Calculating each company's share of total system nuclear investment.* This figure is derived from multiplying the total system investment in nuclear power by a company's nuclear responsibility ratio.

(3) *Calculating each company's share of Grand Gulf costs.* This amount equals the shortfall between the operating company's proportionate share of nuclear costs (estimated in step 2 and that company's own nuclear investment.

Each company would then receive an entitlement to Grand Gulf power corresponding to its relative contribution to Grand Gulf investment costs. 30 FERC at 61,655.

capacity investment or, even more sweeping, equalizing all generating costs—by claiming that the differences among non-nuclear base load[35] generation costs were minor compared to the cost differences among the nuclear generating facilities. 26 FERC at 65,110. He suggested that even under his proposal AP&L would still have the lowest total generation costs on the system. *Id.* at 65,119. He justified his decision to reallocate costs of Grand Gulf primarily by reference to the fact that the UPSA perpetuated discrimination caused by the timing of nuclear units by forcing the Louisiana and Mississippi ratepayers to pay about four times more for nuclear capacity than the Arkansas ratepayers would pay for their nuclear kilowatts. *Id.* at 65,107.

2. *ALJ Head's decision in the System Agreement case (ER82-483).* The principal issue in the System Agreement proceeding was whether FERC should approve that Agreement as filed or whether it should equalize[36] all or part of the production costs on the system. 30 FERC at 65,120. ALJ Head also considered a series of arguments militating against FERC jurisdiction over the reallocation of Grand Gulf costs and rejected them.[37]

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[35] "Base load" units are those units that are in continuous operation. By contrast, reserve units (oil and gas units) can be fired up quickly to meet special surges in demand. 483-R. 7112, VII JA 1564.

[36] In this context "equalization" does not mean that each operating company would pay the same absolute number of dollars. Rather, it means that each operating company would have to pay a share proportionate to its share of system demand.

[37] He rejected the following contentions: (1) that a reallocation of Grand Gulf costs violates the *Mobile-Sierra* doctrine, 30 FERC at 65,146-47; (2) that such a reallocation violates the ban on federal regulation of "generating" facilities contained in § 201(b) of the FPA, 16 U.S.C. § 824(b) (1982), 30 FERC at 65,148-50; (3) that such a reallocation constitutes a "forced sale" of power, barred by § 202(b) of the FPA,

Having found that FERC had the authority to reallocate production costs, ALJ Head faced the following alternatives:

> (1) *Adoption of the System Agreement as filed.* This would entail allocating none of the Grand Gulf costs to AP&L and only equalizing the costs of capacity between "long" and "short" companies, with equalization payments pegged to the cost of the long companies' oil and gas investment costs.[38]
>
> (2) *Equalization of production costs.* The basic concept,[39] presented by the Louisiana Public Service

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16 U.S.C. § 824a(b) (1982), 30 FERC at 65,154; (4) that such a reallocation expands federal regulation of a utility's rate base in a manner that improperly limits the power of the states over retail rates, 30 FERC at 65,149-51; (5) that the Public Utility Holding Company Act, 15 U.S.C. § 79 *et seq.* (1982), bars FERC jurisdiction in this matter, 30 FERC at 65,152-54; and (6) that the reallocation of Grand Gulf costs by FERC would present an obstacle to state certification of new generating plants. 30 FERC at 65,154.

[38] 30 FERC at 65,139. This proposal was supported by AP&L and various Arkansas interests in the proceedings before ALJ Head. The Arkansas parties continue to press this position on appeal.

[39] There were two variations on this theme:

> (a) *Base load equalization.* This proposal would have required each operating company to bear a share of the system's "base load" (coal and nuclear) capacity proportionate to its share of system load. 30 FERC at 65,140. This proposal was supported by the Commission staff in the proceedings before ALJ Head and was before the Commission. 31 FERC at 61,635 & n.5. No party, however, has pressed this position on appeal.
>
> (b) *Base load equalization combined with rough equalization of intermediate capacity.* This proposal would require base load capacity to be allocated in proportion to relative system demand while all other capacity would be equalized under the terms of the 1982 System Agreement, *i.e.*, short companies would compensate long com-

Commission, was to allocate responsibility for a share of *all* production costs on the MSU system proportionate to each company's share of the system's total load.[40]

(3) *Making Grand Gulf a participation unit.* This proposal would allocate responsibility for Grand Gulf capacity to each operating company to the degree that the company in question was "short." Under this scheme responsibility for Grand Gulf capacity would shift over time.[41]

ALJ Head rejected all of these proposals. He rejected the concept of making Grand Gulf 1 a participation unit primarily because it would allow long companies (*e.g.*, MP&L) to avoid completely the high front-end costs associated with that plant. 30 FERC at 65,166-67. He rejected the equalization proposals on the ground that overall cost equalization would be inconsistent with the general "pattern of autonomy * * * particularly as to * * * specific plant site locations, fuel and financing" that he found characterized the operating companies in the MSU system. *Id.* at 65,168.

ALJ Head found support for his finding of a "pattern of autonomy" in two circumstances. First, he stressed that the historic practice in the MSU system was to equalize only *excess* capacity. *Id.* at 65,167. Second, he

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panies, with equalization payments pegged to the cost of the long companies' intermediate (oil and gas) units. 30 FERC at 65,141. This proposal was put forward by the City of New Orleans before ALJ Head and the Commission. 31 FERC at 61,635 & n.6. It is not pressed on appeal.

[40] 30 FERC at 65,141. This proposal was put forward by the Louisiana Public Service Commission. It continues to press this position on appeal.

[41] 30 FERC at 65,141. This proposal was put forward by the Mississippi Public Service Commission. MPSC continues to press this position on appeal.

insisted that "generation additions in almost every instance (except for Grand Gulf) were made primarily to satisfy individual company needs." *Id.* at 65,168.[42]

ALJ Head, however, found that Grand Gulf constituted an "anomaly" in the MSU system:

> Grand Gulf from its inception was planned, presented to the licensing authorities and constructed as a system plant not only to serve the needs of MP&L but to serve the needs of all the operating companies on the system.

30 FERC at 65,170.[43]

He therefore deemed it appropriate to reject the System Agreement as filed and to allocate the costs of the Grand Gulf investment among all of the operating companies. Unlike ALJ Liebman, however, he held that this allocation should fluctuate from year to year to track each company's relative demand for the system's energy. 30 FERC at 65,172.

3. *FERC's initial decision.*[44] In Order No. 234 the Commission summarily affirmed both ALJs on the thresh-

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[42] Even ALJ Head conceded, however, that all of the operating companies would benefit from the economies of scale realized when an individual company built a plant providing more capacity than that company could absorb at the time. Moreover, he found that MSU was a "highly integrated system" which sought to achieve such economies of scale through "common planning." 30 FERC at 65,168.

[43] Specifically, ALJ Head was impressed by the following facts: (1) the Grand Gulf project was an amalgam of the nuclear units assigned to MP&L and NOPSI; (2) the plant was planned on the basis of the combined load forecasts of all of the operating companies; (3) it was clear all along that the facility would produce much more energy than MP&L could ever use; and (4) the Atomic Energy Commission approved the Grand Gulf license because the entire system had placed its credit behind MSE. 30 FERC at 65,170-71.

[44] FERC reviewed both ALJs' decisions in issuing Order No. 234, even though it had previously declined to consolidate

old issue of its own jurisdiction to amend the Sales Agreement and the System Agreement. 31 FERC at 61,643-46.[45] On the merits, the Commission affirmed both ALJs' findings that MSU constituted an "integrated electric system." 31 FERC at 61,645. The Commission, however, specifically rejected ALJ Head's finding that the MSU system displayed a "pattern of autonomy" with regard to the planning and construction of generating units. *Id.*

The Commission conceded that MSU's system of overlapping officers and directors and the representation of the operating companies on the System Operating Committee gave the operating companies substantial influence in the development of the system's plans. *Id.* at 61,646. FERC further observed that the individual companies used their influence to seek the addition of generating units that met their particular needs, and that Section 4.01 of the System Agreement made each operating company responsible for financing the ownership or purchase of the generating capacity necessary to service its customers. *Id.* at 61,649. The Commission nonetheless concluded that "major critical decisions, including decisions to build new generating units, are made by the Operating Committee for the benefit of the system as a whole." *Id.* at 61,646. *See also id.* at 61,650.

The Commission buttressed its conclusion with the following evidentiary support: (1) Section 4.01 of the 1982 System Agreement provides that the Operating Committee shall "determine" the system generation addition plans;[46] (2) at least five witnesses testified that new

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the two cases. *See* 21 FERC ¶ 63,039 (1982), *aff'd*, 22 FERC ¶ 63,015 (1983).

[45] The Commission rejected the jurisdiction arguments ALJ Head had considered in the System Agreement case, *see* note 37 *supra*, with the exception of the state certification challenge.

[46] The 1973 System Agreement had stated that the Operating Committee "assigns" responsibility for new generating

units were added to address the needs of the system as a whole, *id.* at 61,646-48; and (3) the Operating Committee minutes over a twenty-year period revealed that the Committee had the responsibility and the authority to make the "critical decisions" concerning the addition of generating capacity. *Id.* at 61,648-49.

The Commission's review of the Operating Committee minutes revealed that the Operating Committee did not merely rubber-stamp the requests of the individual operating companies concerning the addition of generating capacity. *Id.* at 61,649. The Commission found that the Operating Committee consistently based its generation plans on the needs of the system as a whole. *Id.* at 61,649-50. It found that the Operating Committee had authority over the general timing, location, and size of plant additions, while the individual operating companies retained authority to fill in the details of such fundamental decisions. *Id.* Thus FERC stated that there was no evidence in the record that an operating company had ever built a new plant without a recommendation from the Operating Committee or that one had ever refused to carry out such a recommendation. *Id.* at 61,651.[47]

In light of this finding, FERC rejected ALJ Head's contention that Grand Gulf was an "anomaly." Instead it agreed with ALJ Liebman that Grand Gulf, like every other generating station, was built to serve the needs of

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units to particular operating companies; the 1982 System Agreement does not use the word "assigns." Notwithstanding this change, the Commission found the 1982 Agreement to vest the same authority in the Operating Committee over allocation of responsibility for generating units as had existed in previous System Agreements. 31 FERC at 61,646.

[47] The Commission also noted that changes in the 1982 Agreement had enhanced the power of the Operating Committee to override the wishes of an individual operating company by providing for majority rule rather than a two-thirds vote. This provision made it impossible for a single company to block a Committee decision. 31 FERC at 61,651.

the system as a whole and to attain the system-wide goal of diversifying MSU's fuel mix. *Id.* at 61,653. MSE was deemed a mere financing shell that the Commission hypothesized would have been made available to any other operating company that suffered the financial difficulties encountered by MP&L. *Id.* at 61,654.

The Commission viewed the decision to move into nuclear power as a system-wide decision calculated to meet system-wide needs. It found that MSU's nuclear project had run afoul of unforeseen economic difficulties that had disrupted the system's historic rough equalization of generation costs. FERC therefore adopted ALJ Liebman's scheme [48] of allocating Grand Gulf costs so that each operating company would contribute proportionately to the system's investment in nuclear capacity. *Id.* at 61,655.[49]

4. *FERC's opinion on rehearing.* In Opinion No. 234-A FERC clarified its position on the various jurisdictional arguments it had addressed in its initial decision. 32 FERC at 61,943-52. The Commission also addressed—and rejected—the argument raised by various Arkansas parties that FERC lacked jurisdiction as there was no interstate sale of power. The Commission suggested that, whatever the merits of such an argument where a "monolithic" system is concerned, there was no question but that the transfer of power among the MSU operating companies constitutes a "sale for resale." *Id.* at 61,957.

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[48] The Commission declined to update the cost estimates for the Grand Gulf and Waterford 3 units, stating that both the cost and pertinent demand projections were constantly changing. 30 FERC at 61,657.

[49] In its initial decision the Commission did not expressly discuss the rationality of the alternatives to ALJ Liebman's approach presented in the record of ER-483. It implicitly addressed these concerns by adopting the ALJ's analysis. 31 FERC at 61,655.

Indeed, a major portion of the Commission's opinion on rehearing was dedicated to clarifying the Commission's essential finding concerning the "integrated" character of the MSU system. The Commission rejected any attempt to mischaracterize its decision as based on a view that MSU is a "monolith." *Id.* at 61,952. FERC simply insisted that, whatever the powers of the individual operating companies, the MSU Operating Committee makes the "*major* critical decisions on the System, *primarily* for the System as a whole." *Id.* at 61,953 (emphasis in original).[50] The Commission emphasized that its opinion hinged on "a variety of factors including the manner in which decisions are made by the commonly owned affiliates, and for whose primary benefit those decisions are made." *Id.* at 61,956.

Turning to the merits, the Commission addressed three challenges to the rationality of its allocation of Grand Gulf costs. It disputed the contention of the Arkansas parties that the allocation violated the spirit and practice of the MSU system, the System Agreement, and the intent of the parties to that Agreement. FERC responded that the clear intent of the System Agreement was to correct major cost imbalances while moving toward a mixed fuel base including nuclear and coal-fired facilities. The Commission insisted that it need not measure the rationality of its allocation from the vantage point of the parties at the time the UPSA was first negotiated. *Id.* at 61,957-59.

The Commission also addressed the argument of MP&L that the Commission's order had only exacerbated the

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[50] FERC also disputed AP&L's contention that at least on one occasion an operating company had refused to build a unit despite a "recommendation" by the Operating Committee that it do so. FERC noted that although it was true that LP&L had never built coal units in northern Louisiana in the early 1980's, there was no record evidence suggesting actual defiance of the Operating Committee. 32 FERC at 61,953-54.

discrimination it would have suffered under the original UPSA scheme. MP&L noted that under the UPSA it would have been responsible for 31.63% of Grand Gulf, but under the Commission's scheme it would be responsible for a full 33%. 31 FERC at 61,959. Under the new scheme Mississippi would receive only 9.5% of the system's nuclear capacity while paying for 15% of the system's nuclear investment. 32 FERC at 61,964 n.26.

The Commission responded by asserting that the mere fact that FERC's order increased MP&L's burden did not make it more discriminatory. It is completely rational, argued the Commission, that a smaller burden can be discriminatory and, with a change in the relative standing of the parties, a larger burden can be fair. The original allocation was discriminatory, in the Commission's view, because AP&L had failed to share the burden of Grand Gulf. Although the Commission's order would increase MP&L's allocation somewhat, it would spread the overall burden of Grand Gulf more equitably by making AP&L carry a portion of the burden.

The Commission suggested that its refusal to reallocate the capacity of all nuclear units (as well as their costs) was justified by the MSU system's historic aversion to equalizing all costs per kilowatt. *Id.* at 61,959. It stressed the same point in responding to the arguments of various Louisiana parties that it should have adopted full cost equalization. *Id.* at 61,961. Thus the Commission depicted its opinion as an attempt to balance

> the need to provide an equitable sharing of the investment costs of units that have (or could have) become unforeseeably high due to the unique problems associated with nuclear construction, and the need to recognize the efforts of individual companies on the System and allow them to retain the benefits of units they own to the fullest extent possible.

Id.

Dissatisfied with this rationale, petitioners sought review in this court.

II. JURISDICTION

The petitioners from Arkansas, Missouri and Mississippi raise certain threshold challenges to the Commission's decision. They contend that FERC lacks jurisdiction to modify the allocation of the capacity costs of Grand Gulf embodied in the Unit Power Sales Agreement ("UPSA"). We disagree, and hold that the Federal Power Act ("FPA" or "the Act")[51] provides FERC with authority to issue the orders in question. Initially, we will set forth the affirmative basis of FERC's jurisdiction; thereafter, we will address (and reject) each individual counterargument raised by petitioners.

A. *The Jurisdiction of the Commission*

Section 201 of the Act contains the Commission's basic jurisdictional grant.[52] It provides that "[t]he provisions of this subchapter shall apply to the transmission of electric energy in interstate commerce and to the sale of electric energy at wholesale in interstate commerce" and that "[t]he Commission shall have jurisdiction over all facilities for such transmission or sale . . . ." This section also defines "public utility" as "any person who owns or operates facilities subject to the jurisdiction of the Commission under this subchapter."[53] The facts here reveal that MSE sells Grand Gulf's energy to the affiliated operating companies of the MSU system at wholesale in interstate commerce. Thus, under section 201 of the Act, MSE is a "public utility" and FERC retains jurisdiction over its sales and facilities.

Sections 205 and 206 of the Act set forth the Commission's remedial authority. Section 205(a) establishes a

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[51] 16 U.S.C. §§ 824 *et seq.* (1982).

[52] *Id.* § 824. The states retain jurisdiction over retail rates.

[53] *Id.* § 824(e).

threshold requirement that all "rates and charges" made by a public utility, and "all rules and regulations affecting or pertaining to such rates and charges," must be "just and reasonable," or they will be deemed "unlawful." [54] Most significantly for our purposes, section 206 provides that when the Commission, after a hearing, determines that

> any rate, charge, or classification, demanded, observed, charged, or collected by any public utility for any transmission or sale subject to the jurisdiction of the Commission, *or that any rule, regulation, practice, or contract affecting such rate, charge, or classification is unjust, unreasonable, unduly discriminatory or preferential, the Commission shall determine the just and reasonable rate, charge, classification, rule, regulation, practice, or contract to be thereafter observed and in force, and shall fix the same by order.*[55]

The combined force of these provisions leads inexorably to the conclusion that, under the circumstances presented in the instant case, FERC had jurisdiction to modify the Grand Gulf allocation set forth in the UPSA.

The distribution of Grand Gulf costs and capacity in the UPSA inevitably affects each operating company's generation costs and, by extension, their wholesale rates. When, as here, generation capacity has been built and planned on a profoundly integrated basis, the Commission properly may examine its allocation as a cost component affecting wholesale rates. For this purpose, the UPSA cannot be examined in isolation. As the Commission stated, the UPSA is "an agreement which 'supple-

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[54] 16 U.S.C. § 824d(a) (1982). Section 205(b), 16 U.S.C. § 824d(b) (1982), further provides that no public utility shall, with respect to any jurisdictional sale, "maintain any unreasonable difference in rates, charges, service, facilities, or in any other respect, . . . between localities . . . ."

[55] *Id.* § 824e(a) (emphasis supplied).

ments or supersedes' the coordination arrangements among the MSU utilities, and . . . is a contract 'affecting' rates under the 1982 System Agreement." [56]

The UPSA serves to distribute the Grand Gulf capacity available to MSE—and its cost—among the MSU operating companies. When the Commission acted to modify the UPSA and reallocate the capacity of Grand Gulf, it altered the relative amount of system capacity ultimately paid for by each affiliate. Concurrently, the 1982 System Agreement (Service Schedule MSS-1) established the terms of reserve capacity cost-sharing among the same group. Any change in the allocation of the capacity costs of Grand Gulf in the UPSA will change the relative "longness" or "shortness" of each company under the System Agreement, thus altering the equalization payments made and received for capacity under Service Schedule MSS-1. In the instant case, the cost burden of system generating capacity has been shifted among the affiliates, by virtue of Commission action and system agreement, in order to insure an equitable distribution.[57]

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[56] 32 FERC ¶ 61,425, at 61,949-50 (quoting 31 FERC ¶ 61,304, at 61,627 (1985) (Order on remand)).

[57] The Commission explained the effect of the intersection of the UPSA and the 1982 System Agreement as follows:

> The impact of these Grand Gulf allotments (or any other Grand Gulf allotments) on reserve equalization under Service Schedule MSS-1 of the 1982 System Agreement will likely be a change in the shortness or longness of each member. For example, when Grand Gulf 1 becomes commercially operable, to the extent that the fixed Grand Gulf allotment ratio exceeds (or is exceeded by) the monthly 1982 System Agreement responsibility ratio for a given pool member, that member will become either more long (or short) or less long (or short) for pool reserve equalization purposes. The excess capacity of the long members will be equalized in accordance with the 1982 Agreement, i.e., to the extent a member having excess capacity cannot reach voluntary agreements to sell its excess capacity and energy under Service Schedule

This equitable distribution is mandated by the FPA because of the historical integration of the MSU system.

Capacity costs are a large component of wholesale rates. Thus, the capacity costs of the system carried by each affiliate will significantly affect the wholesale price it pays for energy on the MSU system. In the Commission's view, the UPSA's allocation of Grand Gulf, combined with the provisions of the 1982 System Agreement, created serious inequities in the division of costs of power resources among the operating companies *in light of the integrated planning for generating capability on a system basis.* Unreasonable disparities in the shares borne by affiliates of the total costs of the system's generating capacity plainly "affect" the wholesale rates at which the operating companies exchange energy, and therefore require remedial action by the Commission pursuant to section 206.

A case involving the Northern States Power ("NSP") Companies, *State of Minnesota v. FERC*,[58] provides a helpful illustration of how agreements among affiliates can "affect" rates. The NSP Companies develop and operate both generation and transmission facilities on an integrated basis through participation in a Coordinating Agreement which, *inter alia*, establishes procedures for sharing costs on the system. In 1982, the Companies filed an amendment to that Agreement with FERC proposing a methodology for determining the rate of return on investment as a component of the fixed costs shared

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MSS-4 (Unit Power Purchase), its excess capacity will be equalized among the short members based on the costs of the long member's intermediate generating units under Service Schedule MSS-1 (Reserve Equalization). Any excess energy will be shared with the pool under Service Schedule MSS-3 (Exchange of Electric Energy Among the Companies).

31 FERC ¶ 61,305, at 61,656.

[58] 734 F.2d 1286 (8th Cir. 1984).

under that Agreement. The Minnesota Public Utilities Commission ("MPUC") intervened and contended that FERC lacked jurisdiction to review the amendment because the Coordinating Agreement does not establish a wholesale rate. Specifically, MPUC argued that FERC "exceeded its authority under the Federal Power Act and intruded upon retail ratemaking functions by accepting a filing that sets a rate of return on capital as part of a cost allocation agreement between affiliated power companies." [59]

The Eighth Circuit observed that "MPUC's challenge to the Commission's jurisdiction rests on its contention that the Coordinating Agreement serves simply as a mechanism for allocating costs among the NSP Companies and does not establish a wholesale rate for the resale of electricity." [60] However, the court agreed with the Commission that the Coordinating Agreement "contain[ed] numerous provisions authorizing the NSP Companies to exchange electric power among themselves in return for payment," *i.e.*, interstate wholesale transactions. Thus, the Eighth Circuit held that the Coordinating Agreement established a wholesale rate and that, "[b]ecause a change in the rate of return on investment affects the wholesale rate under the Coordinating Agreement, the Commission possessed jurisdiction to review and approve the proposed amendment." [61]

We are in total accord with the Eighth Circuit's view of FERC's jurisdiction as enunciated in *State of Minnesota*. In the instant case, the petitioners concede that wholesale rates are established in the disputed contracts governing the MSU system; but petitioners nonetheless contend that the Commission does not have jurisdiction here because other portions of these same agreements

[59] *Id.* at 1287.

[60] *Id.* at 1288.

[61] *Id.* at 1289.

allocate generation costs among the MSU companies and these *particular* provisions do not themselves establish a wholesale rate. However, the petitioners ignore the critical point here that, while these provisions do not fix wholesale rates, their terms do directly and significantly *affect* the wholesale rates at which the operating companies exchange energy, due to the highly integrated nature of the MSU system. We conclude that, because the allocation of Grand Gulf capacity and costs, like the rate of return on capital in *State of Minnesota*, significantly *affects* the wholesale rates at which the operating companies exchange energy due to the combined effect of the UPSA and the 1982 System Agreement, that allocation is plainly within Commission jurisdiction.[62]

The Supreme Court quite recently confirmed the propriety of this analysis in *Nantahala Power & Light Co. v. Thornburg*.[63] In that case, FERC examined an agreement between two affiliated power companies, which allocated certain low-cost entitlement power between them.

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[62] In *South Dakota Public Utilities Comm'n v. FERC*, 690 F.2d 674 (8th Cir. 1982), a case also involving the NSP Companies, an amendment to the Coordinating Agreement allocated costs arising from the cancellation of a system nuclear plant project in Wisconsin. The court upheld FERC's decision that the NSP Companies would share the cancellation costs on the basis of a pre-existing arrangement equalizing generating costs in the Coordinating Agreement and quoted with approval the following language from the FERC order:

> The Amendment to the Coordinating Agreement of Northern States Power Company (Minnesota) and Northern Power Company (Wisconsin) filed with the Commission . . . is just and reasonable. It is approved as a rate schedule change pursuant to § 205 of the Federal Power Act subject to the modification ordered in Paragraph (B) below.

Id. at 677. It is noteworthy that no question was raised as to the Commission's jurisdiction to review this amendment to the Coordinating Agreement.

[63] 54 U.S.L.W. 4676 (U.S. June 17, 1986).

FERC found that the agreement was unfair to one of the companies, Nantahala, and increased the percentage of low-cost entitlement power that it should receive. Although FERC did not specifically "reform" the agreement, Nantahala was required to file revised rates, reflecting its increased entitlement to low-cost power. The North Carolina Utilities Commission ("NCUC") not only rejected the actual apportionment agreed to by the companies, but also "employed an allocation of entitlement power that nowhere [took] into account FERC's allocation of that same power." [64]

The Supreme Court held that the NCUC orders were inconsistent with preemptive federal law. The Court observed that

> [a]lthough the [companies' agreements] do not purport explicitly to set a sales price for power, FERC's decision on how Nantahala may treat these agreements in determining its wholesale rates obviously does affect Nantahala's costs directly, and thus Nantahala's wholesale rates.[65]

FERC's allocation of Grand Gulf's costs and capacity, like the setting of entitlement percentages in *Nantahala Power & Light*, does not set a sales price, but does directly affect costs and, consequently, wholesale rates. We cannot disregard the Supreme Court's clear and timely message that FERC's jurisdiction under such circumstances is unquestionable.

Having determined that all MSU generating capacity, including Grand Gulf, had been built and planned on an integrated basis by the MSU system to meet its collective needs and that the allocation of Grand Gulf would affect wholesale rates within the system, the Commission decided that the affiliated operating companies' arrange-

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[64] *Id.* at 4678.

[65] *Id.* at 4681.

ment for sharing of capacity costs—as set forth in the UPSA and the 1982 System Agreement—was unjust, unreasonable and unduly discriminatory. Under these circumstances, sections 205 and 206 of the FPA plainly provide FERC with authority to modify the Grand Gulf allocation agreed to by the operating companies.

B. *Arguments Opposing Jurisdiction*

The petitioners advance various theories to support their contention that FERC lacks jurisdiction to impose the remedy selected in this case. They maintain that: (1) FERC has unlawfully exercised jurisdiction over a generating facility; (2) FERC has unlawfully compelled a purchase of power and generating capacity; (3) FERC has impermissibly intruded on areas subject to state jurisdiction; (4) FERC has contravened the purposes of the Public Utility Holding Company Act ("PUHCA") and infringed upon the authority of the Securities and Exchange Commission ("SEC"); and (5) FERC has violated the *Mobile-Sierra* doctrine. As set forth below, none of these attempts to displace FERC's jurisdiction succeed.

1. *Jurisdiction Over Generating Facilities*

The Arkansas-Missouri petitioners contend that, in allocating the cost and capacity of Grand Gulf, the Commission has asserted jurisdiction over a generating facility in contravention of section 201(b) of the FPA. They maintain that the equalization of nuclear investment by reallocating generation costs falls outside of FERC's rate making jurisdiction and instead falls solely within state authority over generation.

In pertinent part, the statute states:

> The Commission shall have jurisdiction over all facilities for such transmission or sale of electric energy, but shall not have jurisdiction, *except as spe-*

> *cifically provided in this subchapter and subchapter III of this chapter*, over facilities used for the generation of electric energy. . . .[66]

In the same section, the statute provides for

> *Federal regulation of matters relating to generation to the extent provided in this subchapter and subchapter III . . . .*[67]

The Conference Report on the FPA instructs that the italicized phrases were "added to remove any doubt as to the Commission's jurisdiction over facilities used for the generation . . . of electric energy to the extent provided in other sections . . ."[68] The Commission concluded that, in the course of exercising its undisputed jurisdiction over interstate sales of electric energy at wholesale, it lawfully could reallocate the costs of Grand Gulf across the integrated system. Hence, the Commission reasoned that although allocating cost does, to some extent, result in the "regulation of matters relating to generation," such regulation is valid under the FPA when it is the byproduct of a legitimate exercise of FERC's power to regulate wholesale rates.

We agree that FERC has not exercised jurisdiction over generating facilities in any way that violates the FPA. Instead, the Commission is acting pursuant to its exclusive rate authority over wholesale transactions and its remedial authority as set forth in sections 205 and 206.

The Arkansas-Missouri petitioners concede that FERC has jurisdiction to modify the rates and rate-related terms of the UPSA, but deny that this authority encompasses the reallocation of generating capacity. Citing the congressional concern that states maintain control of gen-

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[66] 16 U.S.C. § 824(b) (1982) (emphasis supplied).

[67] *Id.* (emphasis supplied).

[68] H.R. REP. No. 1903, 74th Cong., 1st Sess. 74 (1935).

erating facilities,[69] they assert that the statutory prohibition of federal regulation of such facilities in section 201 (b) becomes meaningless if FERC is permitted to allocate the costs of a plant.

This analysis is flawed. As FERC correctly reasoned:

> We cannot interpret the "but" clause of Section 201 (b) (1) as nullifying the authority granted to us in the first sentence of Section 201(b) (1), in situations where generation facilities are used for interstate wholesale sales. To interpret the statute otherwise would be inconsistent with the declaration in Section 201 (a) that Federal regulation of the sale of energy at wholesale in interstate commerce is necessary in the public interest.[70]

Nor could such an interpretation be reconciled with the Commission's statutory authority to revise contracts affecting rates which are unjust, unreasonable or unduly discriminatory.[71]

The petitioners' general assertion that FERC has improperly infringed upon a state realm by reallocating the costs of Grand Gulf will be dealt with separately *infra*; for the present purpose, it suffices to note that FERC has not regulated a facility, but rather the wholesale rates of interstate sales within the MSU system. It is well-accepted that FERC must allow the recovery of the cost of generating facilities in setting wholesale rates. Here, FERC has simply exercised its undisputed authority over the wholesale rates of electric generating facilities in interstate commerce, which includes, under the facts presented, the authority to reallocate the costs of Grand Gulf across the system. As the statute quite plainly states, FERC's control here is exclusive. The jurisdictional line

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[69] *See* § 201 (b) (1) of the FPA, 16 U.S.C. § 284 (1982).

[70] 32 FERC ¶ 61,425, at 61,947.

[71] *See* 26 FERC ¶ 63,044, at 65,113-14.

drawn by Congress is bright, and FERC stands on the correct side of that line.

The cases cited by the Arkansas-Missouri petitioners are inapposite. In *Connecticut Light & Power Co. v. FPC*,[72] the Supreme Court construed the "local distribution" exception to the Commission's jurisdiction, rather than the "generating facilities" exception, in the context of determining whether to permit regulation of an electric utility located and serving customers exclusively in the state of Connecticut. In its decision, the Court cited the language of section 201(a) of the FPA, "but shall not have jurisdiction . . . over facilities used in local distribution." The lower court had decided that this exemption did not preclude Commission regulation if the Act otherwise provided for the facilities' regulation, *i.e.*, if they carried energy in interstate commerce. The Supreme Court rejected this interpretation of the "but" clause and held that, in order to be subject to FERC jurisdiction, a company must own facilities used in the transmission of interstate power *and not be* a local distribution facility. From this, the petitioners reason that Grand Gulf must be used for interstate wholesale sales *and not be* a generating facility to be subject to FERC jurisdiction.

This interpretation must fail. Initially, we note that the distribution facility at issue in *Connecticut Light & Power* sold energy exclusively within Connecticut; MSE's sales are, without exception, at wholesale and in interstate commerce. Second, the holding in *Connecticut Light & Power* addresses only the "local distribution" exception to the FPA, not the "generating facilities" exception at issue here. Furthermore, the Court's limited discussion of the "generating facilities" exception refutes petitioners' contention. In this discussion, the Court accepts the proposition that FERC may lawfully assert jurisdiction over matters pertaining to generation where it is found that generation facilities are used as facilities for

[72] 324 U.S. 515 (1945).

interstate wholesale sales.[73] In the instant case, the MSE generating facilities are utilized solely for interstate wholesale sales, thus satisfying the Court's test.[74]

2. *Compelled Purchases of Power and Capacity*

The Arkansas-Missouri petitioners also argue that FERC has exceeded its jurisdiction by forcing independent companies—AP&L, for example—to purchase power from Grand Gulf in quantities beyond that agreed to in the UPSA. The Commission found that, as a factual matter, there would be no "forced purchase" due to the integrated nature of the Grand Gulf project and the MSU system and AP&L's individual longstanding, in-depth commitment to Grand Gulf. We agree with the Commission that "the issue here is not whether a company should be forced to purchase or sell power, but rather is the

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[73] 324 U.S. at 528 n.6. (The Court rejected the holding of a previous circuit decision in *Hartford Electric Co. v. FPC*, 131 F.2d 953 (2d Cir. 1942), *cert. denied*, 319 U.S. 741 (1943), but cited with approval the alternative rationale for that decision.)

[74] The Arkansas-Missouri petitioners also cite cases prohibiting FERC from ordering the wheeling of power, *Florida Power & Light Co. v. FERC*, 660 F.2d 668 (5th Cir. 1981), *cert. denied*, 459 U.S. 1156 (1983); *New York State Electric & Gas Corp. v. FERC*, 638 F.2d 388 (2d Cir. 1980), *cert. denied*, 454 U.S. 821 (1981); *Richmond Power & Light v. FERC*, 574 F.2d 610 (D.C. Cir. 1978), or the modification of retail rates, *FPC v. Conway Corp.*, 426 U.S. 271, 276-77 (1976). They maintain that these cases demonstrate that even where the FPA grants power—such as the power over interstate wholesale sales of electric energy—"that grant must be reconciled with [the Act's] limitations on power, such as . . . the lack of jurisdiction over generating facilities." Arkansas Public Service Commission ("APSC") Brief at 28. These cases are inapposite here because, under the clear terms of the statute, the Commission has been awarded jurisdiction over generating facilities "to the extent provided in other sections," including jurisdiction necessary to effectuate regulation of interstate wholesale rates.

appropriate allocation of costs among integrated companies owned by the same parent."[75] The Commission has made detailed findings on the highly integrated nature of the MSU system and on the coordinated planning of the Grand Gulf project. The depth of the operating companies' historical involvement in both the system and the project allows the Commission to step in and reallocate costs under section 206(a) of the FPA so that each of the operating companies is treated fairly.

A consistent line of judicial precedent supports FERC's authority to approve and/or modify the terms of the pooling and coordination agreements of closely integrated power systems when it deems those arrangements unlawful as filed. Over thirty years ago, in *Pennsylvania Water & Power Co. v. FPC*,[76] the Supreme Court considered the Commission's authority to order continued integrated operations by two utilities. For more than 20 years, the companies had been interconnected and had bought and sold power in a coordinated fashion. The FPC ordered a significant reduction in the rates charged by one utility to the other, and the selling utility refused to comply. As a result, the Commission itself prescribed rate schedules to comply with its rate order, requiring the utility to "continue to *buy*, sell, and transmit power in the same coordinated manner" as in the past, though at the decreased rates. The utility objected, but the Supreme Court sustained the order, observing that the integration of utilities is a "practice" within the meaning of section 206 and that the Commission could order its

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[75] 31 FERC ¶ 61,305, at 61,643. The Commission suggests upon reconsideration that its authority is unchanged whether "the central issue is viewed as one of cost allocation or as 'forced' purchases." 32 FERC ¶ 61,425, at 61,949. We do not interpret this comment as an assertion by FERC that it may, under any circumstances, force a purchase among nonaffiliates.

[76] 343 U.S. 414 (1952). *See also* discussion of *Nantahala Power & Light*, *supra* text at notes 63-65.

continuation and determine contract terms suitable to achieve that end:

> The Act gives the Commission ample statutory power to order Penn Water and Consolidated to continue their long-existing operational "practice" of integrating their power output. . . . In ordering such "practice" continued, the Commission was furthering the expressly declared policy of [section 206 of] the Act.[77]

This case provides a solid foundation for the Commission's authority to order a purchase or sale of power when, as here, such an order is consistent with the historical integration of a power pool or network.

This conclusion is further confirmed by the decision of this circuit in *Central Iowa Power Cooperative v. FERC*.[78] In that case, FERC approved a voluntary pooling agreement among some 31 electric systems. The petitioners therein complained that the agreement failed to provide services offered by pooling arrangements established among other electric systems. Because of the voluntary nature of pooling arrangements under section 202(a) of the FPA, the court held that FERC could not order an expansion of pool services merely upon a showing "that a particular pool does not offer the same range of services as another pool."[79] The court, however, went on to determine that FERC did have "specific responsibility in this proceeding to decide whether a particular voluntary pool agreement was unjust, unreasonable, or unduly dis-

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[77] *Id.* at 422-23. The Court specifically noted that the Commission's order was based on authority derived from section 206 of the FPA, and not from the underlying contract between the parties. *Id.* at 422.

[78] 606 F.2d 1156 (D.C. Cir. 1979).

[79] *Id.* at 1167 (quoting with approval the Decision of the Commission).

criminatory," [80] and, in the event of such a finding, that FERC had authority to order expanded services:

> The Commission had authority . . . under section 206 of the Act . . . *to order changes in the limited scope of the Agreement, including the addition of pool services*, if, in the absence of such modifications, the Agreement presented "any rule, regulation, practice or contract [that was] unjust, unreasonable, unduly discriminatory or preferential." [81]

Having found that the agency may exercise authority under section 206 to modify an unlawful voluntary power pool arrangement negotiated by nonaffiliates, *a fortiori* we must conclude that FERC may intervene to reform an unlawful agreement made by affiliates in a fully integrated, commonly owned system.

The cases relied upon by the Arkansas-Missouri petitioners are easily distinguishable. In *Southern Co. Services, Inc.*,[82] Southern Company filed a contract with the Commission to increase sales to Florida Power & Light ("FP&L"). Seminole Electric Cooperative intervened in the proceeding and argued that FP&L should be required to purchase energy from it. Seminole was a stranger to the UPSA at issue in *Southern*, was not affiliated with either Southern or FP&L, and did not contend Southern's rates were unjust or unreasonable under the FPA. Given the entirely inapposite factual setting of *Southern*, FERC's refusal to reject the Southern-FP&L contract or to order FP&L to purchase power from Seminole is irrelevant to the present case.

The Arkansas-Missouri petitioners also maintain that *Otter Tail Power Co. v. FPC*,[83] establishes that compul-

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[80] *Id.* at 1167 n.33.

[81] *Id.* at 1168 (emphasis supplied).

[82] 20 FERC ¶ 61,332 (1982).

[83] 473 F.2d 1253 (8th Cir. 1973).

sory purchases of power may be characterized as a compelled expansion of generating facilities, forbidden by section 202(b) of the Act. In that case, FERC ordered a utility to interconnect with a municipality and to assume the costs of the municipality's generating plant in exchange for energy from the plant. The court determined that this transaction forced the utility to assume beneficial ownership of the plant, *i.e.*, to enlarge its facilities. In the present case, FERC has ordered the operating companies to pay a certain percentage of the capacity costs of Grand Gulf—an entity constructed for system benefit and already within the beneficial ownership of the parent holding company, MSU. The Commission decision does not add any capacity to the MSU system. Nor does it modify the percentage of generating capability for which each company will ultimately bear responsibility under the 1982 System Agreement; it simply alters the composition of each individual company's share.

In relying on *Otter Tail Power*, the parties once again seek to ignore AP&L's role as an affiliated company in an historically integrated system and Grand Gulf's status as a system project. In the factual context of the instant case, the reallocation of capacity costs among the parties cannot be described as a compelled purchase of either power or additional generating facilities.

3. *Intrusion on State Jurisdiction*

The Arkansas-Missouri petitioners and the Mississippi Public Service Commission ("MPSC") separately contend that FERC's orders unlawfully interfere with the jurisdiction of the state regulatory authorities. We will treat the arguments individually.

a. *The Arkansas-Missouri Argument*

Section 201(a) of the FPA provides that FERC's regulation of interstate wholesale sales of electricity extends "only to those matters which are not subject to regulation

by the States." The petitioners assert that the FERC orders interfere with local authority over matters intended to be within the province of state regulators. They reason that FERC's cost allocation has such an extensive impact on the rate base in the state jurisdictions that it, in effect, removes regulation of retail rates and capacity construction from the hands of the state commissions. These assertions are unfounded. FERC has exercised its jurisdiction in order to regulate the sale of electricity at wholesale in interstate commerce in the context of exchanges within a multi-state power pool, an area exclusively subject to FERC control. The fact that FERC's assertion of jurisdiction has some impact on state regulation does not make it unlawful.

As the Supreme Court made clear in *Public Utilities Comm'n of Rhode Island v. Attleboro Steam & Electric Co.*,[84] the states are constitutionally prohibited from exercising jurisdiction over wholesale rates for electricity transmitted and sold in interstate commerce. In the absence of federal action, this holding created a regulatory gap, and Congress enacted Title II of the FPA to fill that gap and provide for federal authority over interstate wholesale rates:

> Congress meant to draw a bright line easily ascertained, between state and federal jurisdiction, making unnecessary . . . case-by-case analysis. This was done in the Power Act by making FPC jurisdiction plenary and extending it to all wholesale sales in interstate commerce except those which Congress has made explicitly subject to regulation by the States.[85]

This holding was confirmed in *Pacific Gas & Electric Co. v. State Energy Resources Conservation & Develop-*

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[84] 273 U.S. 83 (1927).

[85] *FPC v. Southern California Edison Co.*, 376 U.S. 205, 215-16 (1964).

ment Comm'n,[86] in which the Supreme Court observed that states have retained "their traditional responsibility in the field of regulating electrical utilities for determining questions of need, reliability, cost, and other related state concerns" "[w]ith the exception of the broad authority of the . . . Federal Energy Regulatory Commission over the need for and pricing of electrical power transmitted in interstate commerce . . . ."[87]

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[86] 461 U.S. 190 (1983).

[87] *Id.* at 205-06. The Arkansas parties accuse FERC of contravening the Supreme Court's decision in *Arkansas Electric Cooperative Corp. v. APSC*, 461 U.S. 375 (1983). In that case, the Court upheld state jurisdiction over the wholesale rates of a rural power cooperative, in part because the FPC had previously determined that it lacked jurisdiction to regulate these entities which fall under the supervision of the Rural Electrification Administration. The Court, therefore, rejected the old "bright line" between state and federal jurisdiction, *i.e.*, the distinction drawn between regulation of retail or wholesale rates under the commerce clause. Simultaneously, however, the Court emphasized that a new "bright line" between state and federal jurisdiction had been drawn by Congress in the FPA. We hold that the Commission's actions fall within a domain assigned to federal control by the FPA.

Petitioner Arkansas Industries accuses FERC of concluding that federal and state jurisdictions are overlapping and of performing a balancing of the relevant federal and state interests under the commerce clause—a course of action eschewed by the "bright line" test as articulated in *Arkansas Electric*—in its decision to allocate Grand Gulf. As detailed above, we have decided that FERC's allocation of Grand Gulf costs is within its exclusive authority over wholesale rates in interstate commerce under the FPA. The Commission's explicit sensitivity to state concerns in determining the extent to which it would exercise its authority to remedy the unlawfulness of the UPSA is not equivalent to an inquiry under the commerce clause to determine whether a state may regulate in this realm.

As explained above, there is no clash between state and federal jurisdiction in the instant case. FERC's allocation of Grand Gulf was simply an exercise of its authority to regulate wholesale rates in interstate commerce—an area within its exclusive jurisdiction.

The Arkansas-Missouri petitioners contend that the FERC orders deprive state commissions of their control over retail rates. The Supreme Court has recently confirmed that

> [o]nce FERC sets . . . a rate, a State may not conclude in setting retail rates that the FERC-approved wholesale rates are unreasonable. A state must rather give effect to Congress's desire to give FERC plenary authority over interstate wholesale rates, and to ensure that the States do not interfere with this authority.[88]

Thus, once FERC permits a utility to charge a rate reflecting investment in a particular plant, a state commission may be obliged to reflect such an investment in the retail rate base. Under these circumstances, the petitioners argue, state regulatory authorities confronted with a FERC cost allocation will virtually lose control over retail rates.

In *Nantahala Power & Light*, the Supreme Court made clear that, in setting wholesale rates, the NCUC was required to give binding effect to the interstate wholesale rate that had been fixed by FERC. The Court further determined that the realm of preemption was "not limited to 'rates' *per se*" and stated:

> Here FERC's decision directly affects Nantahala's wholesale rates by determining the amount of low-cost power that it may obtain, and FERC required Nantahala's wholesale rate to be filed in accordance with that allocation. FERC's allocation of entitle-

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[88] *Nantahala Power & Light Co. v. Thornburg*, 54 U.S.L.W. at 4680.

> ment power is therefore presumptively entitled to more than the negligible weight given it by NCUC.[89]

Similarly, in the present case, the Commission's allocation of Grand Gulf's costs and capacity affects wholesale rates and, therefore, the state commissions may not "interfere" with FERC's "plenary authority."

Moreover, the petitioners' argument would apply to the costs embodied in any wholesale rate approved by FERC and, therefore, proves too much. In any wholesale rate proceeding, the state commissions may protect their interests, as here, by intervening and presenting evidence before the Commission, a neutral body. The main point here is that FERC plainly had authority to approve or reject the cost allocation pursuant to its jurisdiction over wholesale interstate rates despite its inevitable impact on retail rates.[90]

Moreover, when, as here, affiliated operating companies in an integrated regional system enter into agreements for wholesale power sales in interstate commerce which allocate costs, FERC jurisdiction has additional merits. As ALJ Head observed, "the Commission is perhaps in the best position to reach the most equitable result and to act in the public interest, rather than to be controlled by the necessarily parochial concerns of the States."[91] The basis of this conclusion has been discussed by FERC in another context:

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[89] *Id.*

[90] In *Northern States Power Co. v. Minnesota Public Utilities Comm'n*, 344 N.W.2d 374 (Minn.), *cert. denied*, 104 S. Ct. 3546 (1984), and *Northern States Power Co. v. Hagen*, 314 N.W.2d 32 (N.D. 1981), two state supreme courts determined that their respective state regulatory commissions had to accept and collect the allocated costs of an abandoned nuclear plant project in the retail rates charged for NSP Company power. We endorse the state courts' conclusion that FERC had authority to approve or reject the cost allocation.

[91] 30 FERC ¶ 63,030, at 65,151.

> If State Commission A orders a change to be made in a wholesale rate filing, presumably because it would benefit the ratepayers in State A, then State Commission B might well retaliate by ordering a counter rate filing that would benefit the ratepayers in State B. . . . It was to protect against such competing local state interests that a Federal Commission was given jurisdiction to protect the national interest in transmission and sales for resale in interstate commerce.[92]

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[92] *Western Massachusetts Electric Co.*, 23 FERC ¶ 61,025, at 61,064 (1983). Most recently, the Eighth Circuit spoke to a similar question in the same factual context involved in the instant case. In *Middle South Energy, Inc. v. APSC*, 593 F. Supp. 363 (E.D. Ark. 1984), *aff'd*, 772 F.2d 404 (8th Cir. 1985), *cert. denied*, 106 S. Ct. 884 (1986), the APSC sought to require AP&L to show cause why the UPSA and the other Grand Gulf allocation agreements were not void *ab initio* because the utility had failed to obtain the APSC's prior approval. The district court enjoined the inquiry, holding that it constituted a collateral challenge to the FERC proceedings and an intrusion into a preempted area. On appeal, the Eighth Circuit affirmed, but rested its decision on an alternative finding that APSC's inquiry was an unwarranted burden on interstate commerce. The Eighth Circuit's characterization of APSC's purpose is instructive and highlights the merit of federal regulation in the present case:

> The APSC seeks to cancel the Grand Gulf agreements ostensibly because they have not received the necessary state regulatory approval. Its apparent concern, which has been made abundantly plain in its orders and its arguments before the SEC and FERC, however, is the economic impact on Arkansas citizens caused by AP&L's participation in Grand Gulf. It seeks to deflect what it has estimated to be rate increases of more than $3.5 billion over the next ten years. Given free rein, the APSC would shift this burden to the citizens of Mississippi and Louisiana, citizens who are powerless to directly influence Arkansas' internal affairs.

772 F.2d at 416-17 (footnote omitted).

This same reasoning applies with equal force to a cost allocation among affiliates who exchange power at wholesale in interstate commerce.[93]

b. *The Mississippi Argument*

The MPSC argues that the Commission's orders unlawfully disregard the considerations upon which that state agency relied in certificating construction of Grand Gulf in Mississippi. We find the Commission's analysis and rejection of this argument entirely correct.

MPSC asserts that the utilization of any allocation procedure other than that accepted by it in the Grand Gulf certification proceedings would impermissibly usurp its certification authority. As the Commission found, this assertion is incorrect for several reasons. First, as has been detailed above, state regulatory authorities, in-

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[93] The Arkansas-Missouri petitioners further maintain that FERC's orders usurp state jurisdiction by imposing costs on AP&L for capacity it does not need. This argument appears ludicrous in light of the integrated planning and construction of generating capacity on a system-wide basis. Moreover, none of the operating companies seek Grand Gulf capacity at the present time.

Equally fallacious is the APSC's argument that FERC's orders have unlawfully "remove[d] low cost facilities from AP&L by forcing a sale from those facilities to consumers in Louisiana and Mississippi." APSC Brief at 41. The reallocation of Grand Gulf simply adjusts AP&L's share of MSU's generation capacity costs—costs incurred jointly by the system.

APSC also asserts that it issued certifications for Arkansas' nuclear and coal plants based upon its perception of the needs of AP&L's customers and that it carefully supervised construction of these plants to insure low costs. Hence, the state regulatory authority contends that it would be unfair to impose upon Arkansas generating capacity not subject to similar prior scrutiny. This argument, too, fails; AP&L's supporters are not free to ignore the historical integration of the MSU system and AP&L's continuous involvement and responsibility in planning generation capacity for that system.

cluding the MPSC, do not have authority, as a threshold matter, to approve any allocation of Grand Gulf's cost or capacity among the system operating companies. Such decisions were subject to review and approval by the Commission.

Moreover, the MPSC argument, which it quite properly characterizes as one of equitable estoppel, is untenable under the circumstances. As FERC correctly observed, the Commission itself made no representations to the MPSC; its hands could not be tied by the doctrine, particularly here where its application would lead to "an inequitable result." [94]

Finally, it is noteworthy that the MPSC "did not specifically approve any particular allocation or allocation methodology for Grand Gulf or establish any particular allocation or allocation methodology as a condition of the certificate." [95] This factual prerequisite to the application of the doctrine of equitable estoppel, too, is absent.

For all of these reasons, the MPSC's arguments were properly rejected by FERC.

4. *Intrusion on the SEC's Jurisdiction*

The Arkansas-Missouri petitioners contend that FERC has impermissibly infringed upon the authority of the SEC to regulate the MSU system as a registered holding company under the PUHCA.[96] They further maintain that, by statutory mandate, any conflict between the SEC's authority under the PUHCA and FERC's authority under the FPA must be resolved in favor of the

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[94] 30 FERC ¶ 63,030, at 65,166, *cited in* 31 FERC ¶ 61,305, at 61,645.

[95] 26 FERC ¶ 63,044, at 65,111-12. *See also* 30 FERC ¶ 63,030, at 65,166, *cited in* 31 FERC ¶ 61,305, at 61,645.

[96] 15 U.S.C. §§ 79 *et seq.* (1982).

former.[97] We find no inconsistency in the actions taken by FERC and the jurisdiction of the SEC.

The SEC has correctly explained the division of responsibility between itself and FERC:

> The jurisdiction of this Commission [the SEC] with respect to the availability agreement existed under Section 12(b) of the Act as to the indemnity obligations of the four operating companies to MSE and as to the indemnity that three of the companies gave to APL. *The contracts for the sale of electric energy among the subsidiaries of MSE [sic] are subject to the exclusive jurisdiction of FERC.* Generally a contract for sale of goods and services to an associate company is governed by Section 13(b) of the Act, but Section 2(a)(20), which defines "Sales contract," expressly excludes sale of "electric energy or natural or manufactured gas." [98]

The SEC thus explicitly acknowledged FERC's control over wholesale rates and sales among the operating companies and its statutory authority over the rates and rate-related terms of the UPSA.[99] Moreover, when the

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[97] *See* 16 U.S.C. § 825q (1982).

[98] *In the Matter of Middle South Utilities, Inc., Middle South Energy, Inc.*, SEC PUHCA Release No. 23,579, 32 SEC Docket 416, 419 n.15 (Jan. 23, 1985) (Memorandum Opinion and Order Authorizing Common Stock Sale and Acquisition and Denying Request for Hearing) (emphasis supplied).

[99] The SEC has also observed that

> [t]he operating subsidiaries in the Middle South system have been an integrated system since 1930. As an integrated system, the operating companies have been parties to a series of system agreements governing intercompany sales of electric energy, as well as the planning, construction and operation of generation and transmission facilities. *These agreements are regulated by [FERC] under the Federal Power Act.*

Id. at 417-18 (footnote omitted) (emphasis supplied).

SEC approved the Reallocation Agreement among the system operating companies,[100] it recognized that a rate schedule for the sale of energy would be filed with FERC —a schedule plainly subject to modification pursuant to FERC's authority under the FPA. The SEC itself perceives no conflict between its jurisdiction and that of FERC. Similarly, having determined that the allocation of Grand Gulf is well within FERC's authority over wholesale rates for electric energy in interstate commerce, we, too, have little trouble concluding that there is no conflict with SEC jurisdiction.

Nor do we find merit in the claim that FERC's action is at odds with the goals of the PUHCA. We agree that an important aim of the PUHCA was the elimination of control of some holding companies so that local utilities might be regulated by local authorities. However, the PUHCA itself permits holding companies to own subsidiary utilities when its purposes are best served by focusing on regional rather than state interests, so long as the effectiveness of regulation is not impeded.[101] The PUHCA permits the continued existence of a holding company if its operations are limited "to a single integrated public-utility system," [102] which is defined as follows:

> a system consisting of one or more units of generating plants and/or transmission lines and/or distributing facilities, whose utility assets, whether owned by one or more electric utility companies, are physically interconnected or capable of physical interconnection and which under normal conditions may be economically operated as a single interconnected and coordinated system confined in its operations to a single area or region, in one or more States, not

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[100] *Middle South Energy, Inc.*, SEC PUHCA Release No. 22,280 (Nov. 18, 1981).

[101] *See* 15 U.S.C. § 79k(b) (1982).

[102] *Id.*

> so large as to impair (considering the state of the art and the area or region affected) the advantages of localized management, efficient operation, and the effectiveness of regulation . . . .[103]

The SEC has determined that the MSU system constitutes an "integrated public-utility system." [104] Thus, the regional integration embodied in the structure of the MSU system was clearly contemplated by Congress when it enacted the PUHCA.

Moreover, in the PUHCA itself, Congress recognized "that affiliate power transactions 'are not susceptible of effective control by any State.' " [105] Transactions, such as this one, between affiliated power companies appear to be precisely the type of transactions that Congress sought to regulate by enactment of the Federal Power Act and the Public Utility Holding Company Act of 1935." [106]

5. *The Mobile-Sierra Doctrine*

The APSC maintains that FERC's orders disregard the *Mobile-Sierra* doctrine,[107] which requires the Commission to respect certain private contract rights in exercising its regulatory powers. We find that, in the instant case, this doctrine does not bar the exercise of FERC's power under section 206 of the FPA to reform

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[103] *Id.* § 79b(a)(29).

[104] *Middle South Utilities, Inc.*, 35 S.E.C. 1, 10 (1953).

[105] *State of Minnesota*, 344 N.W.2d at 382 n.17 (quoting 15 U.S.C. § 79a(a) (1982)).

[106] *Id.*

[107] This doctrine is based on the companion cases of *United Gas Pipe Line Co. v. Mobile Gas Service Corp.*, 350 U.S. 332 (1956), and *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348 (1956).

a practice or contract affecting a rate charged by a public utility for wholesale service in interstate commerce.

In the *Mobile* case, the Mobile Gas Service Corporation ("Mobile"), a natural gas distributor, had entered into a long-term contract with the United Gas Pipe Line Company ("United") to purchase gas for resale to an industrial customer, Ideal Cement Company ("Ideal"). Ideal had a reciprocal contract to buy the gas from Mobile. The Mobile-United agreement had been filed with the Commission and was part of United's filed schedule of rates. Subsequently, United, acting without the consent of Mobile, altered the rates specified in its contract with Mobile by filing with the Commission a new rate schedule purporting to increase the rate on gas sold to Mobile for resale to Ideal. Mobile challenged United's action, and the Supreme Court held that the Natural Gas Act does not permit natural gas companies to change their rate contracts by unilateral action.

Thereafter, in *Sierra*, the Court applied its holding in *Mobile* to cases arising under the FPA. Thus, neither the filing of a new rate nor a finding that it is reasonable may abrogate a utility's contract with a distributor. "Together, the two cases make it crystal clear that a heavy burden must be met before a customer who has negotiated a fixed-price contract can be deprived against his will of the benefits of his bargain." [108]

APSC suggests that, in reforming the UPSA, FERC has snatched from AP&L the favorable result of its contractual escape from responsibility for Grand Gulf in contravention of the *Mobile-Sierra* holdings. We disagree. Initially, we note that the UPSA itself expressly permits unilateral changes in the contract by MSE:

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[108] *Town of Norwood v. FERC*, 587 F.2d 1306, 1310 (D.C. Cir. 1978).

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> Nothing contained herein shall be construed as affecting in any way the right of MSE to unilaterally make application to FERC for a change in the rates contained herein or any other term or condition of this Agreement under Section 205 of the Federal Power Act and pursuant to FERC Rules and Regulations promulgated thereunder.[109]

Moreover, the UPSA makes no mention of any restriction on the Commission's authority to reform agreements under section 205 or section 206 of the FPA.[110] This circuit has made it clear that parties may agree to unilateral rate filings[111] and that parties may agree to "leave unaffected" the Commission's power to replace rates, and terms affecting rates, that are either contrary to the public interest or unjust, unreasonable, unduly discriminatory or preferential to the detriment of the contracting parties.[112] The signatories to the UPSA elected to

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[109] 616-R. 2982, I J.A. 246.

[110] In fact, the record suggests that the parties contemplated FERC review of the terms of the UPSA. *See* Reallocation Agreement, July 28, 1981. 616-R. 3275, I J.A. 268 ("2. An agreement between LP&L, MSE, MP&L and NOPSI will be executed in form for filing with the Federal Energy Regulatory Commission in accordance with Part 35 of the Commission's Regulations establishing the terms, conditions and rates for the sale of capacity and energy from MSE to LP&L, MP&L and NOPSI. . . . 7. The effectiveness of this Agreement is subject to the receipt of all necessary regulatory approvals.").

[111] *See Papago Tribal Utility Authority v. FERC*, 723 F.2d 950, 953 (D.C. Cir. 1983), *cert. denied*, 104 S. Ct. 3511 (1984); *Kansas Cities v. FERC*, 723 F.2d 82, 87 (D.C. Cir. 1983).

[112] *Papago Tribal Utility Authority*, 723 F.2d at 953. The APSC incorrectly suggests the Supreme Court's holding in *Sierra* made the public interest standard the sole criteria for contract revision in section 205 or section 206 proceedings.

permit unilateral rate filings and not to restrict the Commission's power.[113] The parties' bargain itself contemplates the Commission's review, and potential reform of their agreement; the *Mobile-Sierra* doctrine requires no more.[114]

Finally, even if the contracts fall within the scope of the *Mobile-Sierra* decisions, the Supreme Court has emphasized that the relevant agency, here FERC, may always reform a contract found to be "unlawful" or "contrary to the public interest," *i.e.*, that "contracts remain fully subject to the paramount power of the Commission to modify them when necessary in the public interest." [115] The Court stated in *Sierra* that the Commission "has undoubted power under § 206(a) to prescribe a change in contract rates whenever it determines such rates to be unlawful" [116] and indicated three circumstances under which the Commission might conclude that a rate or a contract term affecting a rate could be found

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In fact, as this court has made clear, either the interest of the public *or* the interest of the parties in nondiscriminatory rates will suffice to justify the *Commission's* decision to reform rates, *id.* at 954 n.5, so long as the parties' contract does not eliminate the Commission's authority over discrimination or preference that operates only against the signatories. Such discrimination may be waived "up to the point where it produces some independent harm to the public interest," *id.* at 953 n.4, but no such waiver took place in the instant case.

[113] "[C]ourts and the Commission have almost universally construed contractual references to future rate changes to authorize § 206 proceedings with a just-and-reasonable standard of proof." *Kansas Cities*, 723 F.2d at 88.

[114] *See Richmond Power & Light v. FPC*, 481 F.2d 490, 493 (D.C. Cir.) (describing the *Mobile-Sierra* doctrine as "refreshingly simple: . . . Rate filings consistent with contractual obligations are valid; rate filings inconsistent with contractual obligations are invalid."), *cert. denied*, 414 U.S. 1068 (1973).

[115] *Mobile*, 350 U.S. at 344.

[116] *Sierra*, 350 U.S. at 353.

contrary to the public interest and therefore subject to revision: "where it might impair the financial ability of the public utility to continue its service, cast upon other consumers an excessive burden, or be unduly discriminatory." [117] Here FERC expressly adopted the findings of ALJ Liebman who found the level of discrimination in the UPSA "profound" and agreed that its impact on customers in Louisiana and Mississippi would be "dramatic[]." [118] The Commission's specific determination of unlawfulness provides the "unequivocal public necessity" [119] for reformation of the UPSA under section 206 of the FPA.

For each of the foregoing reasons, the *Mobile-Sierra* doctrine does not preclude FERC's actions in the instant case.

C. *Conclusion*

For all of the foregoing reasons, we reject petitioners' principal contentions with respect to FERC's jurisdiction. We have also considered all other arguments suggesting that the Commission is without jurisdiction in this case, and we find them to be without merit. The Federal Power Act clearly provides FERC with authority to issue the orders here in question. We now turn to the merits of this case.

III. Merits

Petitioners challenge FERC's decision to reject the Unit Power Sales Agreement and to equalize nuclear capacity among the MSU operating companies. In the process, many advocate adoption of a particular, alternate allocation. We reject these challenges because we conclude that FERC's action was both rational and within

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[117] *Id.* at 355.

[118] 26 FERC ¶ 63,044 at 65,108 & 65,104.

[119] *Permian Basin Area Rate Cases*, 390 U.S. 747, 822 (1968).

the Commission's range of discretion to remedy unduly discriminatory rates. We first examine the workings of the UPSA and the 1982 System Agreement and then review the evidentiary basis for FERC's determination that the Agreements as filed were unduly discriminatory. We then address petitioners' claims that FERC was required to adopt a remedy other than the one it chose. Finally, we consider several remaining issues such as Commissioner Richard's refusal to recuse himself and FERC's refusal to reopen and update the record.

A.

Under section 206 of the Federal Power Act ("FPA"), FERC must determine whether an agreement as filed is "unjust, unreasonable, unduly discriminatory or preferential." 16 U.S.C. § 824e(a) (1982). If the agreement is just and reasonable, then it is approved as filed. If, on the other hand, the agreement is unduly discriminatory, then FERC is required to "determine the just and reasonable . . . contract to be thereafter observed and in force, and shall fix the same by order." *Id.*

In this case, FERC reviewed "two initial decisions in dockets which are not consolidated but which have overlapping issues concerning the appropriate allocation of capacity costs incurred on the . . . (MSU) system." 31 F.E.R.C. (CCH) at 61,631. Thus, FERC considered whether the UPSA and the 1982 System Agreement, taken together, were just and reasonable.

To understand the Commission's decision, it is necessary to examine the workings of the UPSA and the System Agreement in detail. The UPSA resulted from negotiations among the four operating companies and MSE in 1979. These negotiations produced the 1981 Reallocation Agreement in which the companies agreed that all Grand Gulf power would be purchased by LP&L, MP&L and NOPSI in definite percentage shares. AP&L relinquished all interest in Grand Gulf, and the other operating com-

panies agreed to indemnify and hold AP&L harmless for its obligations to lenders under the 1974 Availability Agreement.

Pursuant to the Reallocation Agreement, the parties executed the UPSA in June 1982 to be filed with FERC. The UPSA provides in pertinent part:

> 1.2 The Purchasers shall, subject to the terms and conditions of this Agreement, be entitled to receive all of the Power which shall be available to MSE at the Project in accordance with their respective Entitlement Percentages. The Entitlement Percentages are as follows:
>
> | | Entitlement Percentages Unit No. 1 |
> |---|---|
> | LP&L | 38.57% |
> | MP&L | 31.63% |
> | NOPSI | 29.80% |
> | | 100.00% |

26 F.E.R.C. (CCH) at 65,097. The UPSA further provides that LP&L, MP&L and NOPSI shall pay MSE the same proportionate shares of the total capital and operating costs of the Grand Gulf unit. *Id.* Thus, the UPSA allocates Grand Gulf *capacity* and *energy* in identical shares.

Meanwhile, in April 1982, MSU filed the 1982 System Agreement with FERC to create a new rate schedule for the generation and consumption of the System's energy. A critical aspect of the 1982 System Agreement, for our purposes, is that it does not apply to Grand Gulf. That is, it assumes the existence of the UPSA and its allocation of Grand Gulf capacity and energy. Thus, the 1982 System Agreement may be read and applied properly only by recalling the Grand Gulf allocations fixed by the UPSA.

Under the 1982 System Agreement, capacity and energy costs are allocated separately. As for energy, each com-

pany is entitled to first call on the lowest cost energy generated by the plants located within its service area (and by Grand Gulf up to its UPSA percentage entitlement). The energy generated by a company's plants in excess of that company's demand goes into a pool of energy available to companies whose plants produce less energy than they demand. Such companies may purchase the lowest cost energy available in the pool.

The 1982 System Agreement also establishes a formula to equalize roughly the costs of *capacity* to generate energy. This is achieved by equalizing capacity among the operating companies with corresponding capacity equalization payments. Companies that are "long" on capacity—*i.e.*, those whose percentage of total System capacity exceeds their percentage of total System demand—contribute their excess capacity to "short" companies—*i.e.*, companies whose percentage of total System capacity is less than their percentage of total System demand. In return, the "short" companies make capacity equalization payments to the "long" companies. Under the 1982 System Agreement, these payments are based on the investment costs of "intermediate" oil and gas fired generation facilities, which are much lower than the investment costs of newer coal and nuclear units. In determining whether, and to what extent, a company is long or short, the System considers not only the capacity of units located in that company's service area, but also the share of Grand Gulf capacity to which that company is entitled under the UPSA.

The operating companies intended to roughly equalize the System's capacity costs among themselves by executing the UPSA and the 1982 System Agreement. And, indeed, *at the time they were negotiated*, these agreements appeared to achieve that objective. When the UPSA was negotiated in 1979, Grand Gulf capacity appeared to be a good buy. The initial cost estimate for building *both* Grand Gulf units was $1.3 billion; by the

time the first unit began operations in 1985, however, the final cost for that unit alone was $2.7 billion. It seems unlikely that, in 1979, the companies could have foreseen that the cost of completing Grand Gulf would quadruple because of the lengthy regulatory delays that would occur in the aftermath of the Three Mile Island accident. The System Agreement's formula for roughly equalizing capacity costs among the companies also appeared reasonable when negotiated. Capacity equalization payments were based on the costs of oil and gas fired units, rather than the more costly nuclear and coal fired units. Historically, a company's ability to construct oil and gas fired units depended on the existence of sufficient natural resources within its service area. By contrast, the ability to build coal and particularly nuclear units was less restricted. Thus, when the System decided to shift to coal and nuclear capacity, each of the operating companies was assigned to build nuclear capacity: AP&L was assigned ANO I & II; LP&L was assigned Waterford III; MP&L was assigned Grand Gulf I; and NOPSI was assigned Grand Gulf II. The cost of nuclear capacity was assumed to be roughly equivalent. Thus, each company would share in the cost of the older oil and gas capacity—either by having constructed it or by making capacity equalization payments—and each company would share in the cost of the System's newer capacity—by constructing nuclear and/or coal fired units.

By the time the Commission reviewed the UPSA and the System Agreement, however, conditions had changed radically. Though AP&L had successfully completed the ANO units without substantial cost overruns, *see* 31 F.E.R.C. (CCH) at 61,669 n.17, the cost of constructing Grand Gulf I and Waterford III approached three to four times original estimates. As ALJ Liebman recognized, "[d]isparate rates are legitimate under section 205(b) of the FPA if sufficient factual bases exist to justify the difference." 26 F.E.R.C. (CCH) at 65,106 (*citing Metropolitan Edison Co.* v. *FERC*, 595 F.2d 851, 857, 858

(D.C. Cir. 1979)). Upon reviewing the nature and operation of the MSU System, Judge Liebman concluded that the facts were insufficient to outweigh "the profound undue discrimination caused by [the UPSA] allocation." *Id.* at 65,108. The Commission affirmed, concluding that "the 1982 System Agreement and the UPSA, as filed, together will [not] achieve proper cost allocation," and that "the 1982 System Agreement in conjunction with Judge Liebman's allocation of nuclear capacity will achieve just and reasonable results." 31 F.E.R.C. (CCH) at 61,655.

B.

The Commission based its decision primarily upon two findings: (1) "the fact that all Middle South System nuclear units have been planned to meet overall System needs and objectives," and (2) "the unforeseen problems unique to constructing nuclear units." 31 F.E.R.C. (CCH) at 61,655 (footnote omitted). The Commission's first finding is more than adequately supported by the record. The Commission began by discussing the composition of, and key role performed by, the System Operating Committee. The Operating Committee is composed of five members: one representative from each of the four operating companies and one from the System's wholly-owned service company, Middle South Services, Inc. ("MSS"). *See* 31 F.E.R.C. (CCH) at 61,646; 30 F.E.R.C. (CCH) at 65,143. The Commission undertook a thorough review of the record testimony of current and former System executives, *see* 31 F.E.R.C. (CCH) at 61,646-48, as well as various sets of minutes of the System Operating Committee from 1961 to 1980, *see id.* at 61,648-50. This evidence amply supports the Commission's conclusion that although individual operating companies were intimately involved in the planning stages of new generation units and sought to promote their own interests, "the Operating Committee nevertheless made the major decisions concerning general timing, location and size of plant additions, in view of the overall needs of the system,

while accommodating individual company needs wherever possible." *Id.* at 61,650. For example, Mr. Trumps, an MSS official, testified that "generation planning has been done on a systemwide basis, but with due consideration of the needs of the individual companies as to the location of new facilities." *Id.* at 61,647. Mr. Trumps also testified that under the 1973 System Agreement, an individual operating company could not block an Operating Committee decision since that body acted by two-thirds vote, and that the 1982 System Agreement further strengthened the Committee's position by authorizing decisions to be made by majority vote. *See id.* at 61,651.

In making its findings about the System's planning and operations, FERC expressly rejected ALJ Head's contrary findings as unsupported by the evidence. First, the Commission rejected Judge Head's conclusion that there is "a pattern of autonomy on the part of the individual operating companies, particularly as to specific plant site locations, fuel and financing." 30 F.E.R.C. (CCH) at 65,168. The Commission acknowledged that the operating companies "exercise[] their authority to decide details such as specific location, timing, and sizing of [an assigned] unit," 31 F.E.R.C. (CCH) at 61,650, but rightly concluded that this fact does not affect the finding that "decisions on the MSU System are made based on an overall *System* plan and primarily for the System as a whole," *id.* (emphasis in original).

Second, and more important for our purposes, the Commission rejected ALJ Head's determination that Grand Gulf is "an anomaly to the regular planning and construction of generating facilities by the operating companies of the Middle South system." 30 F.E.R.C. (CCH) at 65,172. Again, the Commission's conclusion is supported by the record. Relying on the testimony of Mr. Lupberger, an officer of MSU, MSE and MSS, the Commission began by recalling that in the late 1960's and early 1970's, the System decided to change its fuel mix

by shifting away from oil and gas generation in favor of nuclear and coal capacity. *See* 31 F.E.R.C. (CCH) at 61,651. Pursuant to that decision, AP&L was assigned to build the ANO units and MP&L was assigned to construct Grand Gulf I. After reviewing the relevant testimony, FERC concluded that "[t]he evidence supports a finding that the Grand Gulf units were originally planned in the same manner as the other nuclear units, *i.e.*, to meet MP&L's needs, to meet System needs, and to meet the System goal of diversifying fuel mix." 31 F.E.R.C. (CCH) at 61,653. The Commission recognized that the way in which Grand Gulf had to be financed, *see supra* pp. 17-18, resulted in differences between Grand Gulf and other system units, all related to the fact that MSE, rather than an individual operating company, owns and operates the plant. *See id.* But, as FERC correctly observed, these differences "arose solely from the fact that MP&L became unable to finance the Grand Gulf units on its own. They do not contradict the fact that Grand Gulf 1 and 2 were planned in the same manner as the other nuclear units on the system." *Id.* at 61,653-54. Indeed, Mr. Lupberger's testimony was that the system employed the same general process in deciding to build Grand Gulf as it did in deciding to build the ANO units. *See id.* at 61,654.

Having determined that "all Middle South System nuclear units have been planned to meet overall System needs and objectives," 31 F.E.R.C. (CCH) at 61,655, the Commission's conclusion that the UPSA and the 1982 System Agreement, as filed, were unduly discriminatory follows almost as a matter of course. Under the Agreements as filed, the cost of nuclear capacity varied widely from company to company. For example, the cost to AP&L for its 1694 megawatts of nuclear capacity was $900 million, while the cost to LP&L for 1538 megawatts was $3.4 billion, approximately four times as much. *See* 26 F.E.R.C. (CCH) at 65,107. Similarly, the cost to MP&L for 356 megawatts and to NOPSI for 335 mega-

watts was $800 million and $700 million, respectively, while AP&L received 1694 megawatts, approximately five times the capacity of either, for just $900 million. *See id.* As already discussed, the 1982 System Agreement's provision for capacity equalization payments does little, if anything, to reduce these vast nuclear capacity cost disparities. That is because AP&L is currently a "long" company, *see* 30 F.E.R.C. (CCH) at 65,166, and, in any event, capacity equalization payments are based on the costs of oil and gas fired units rather than more costly nuclear units such as Grand Gulf and Waterford III. Given the degree of integration on the MSU System, FERC could properly conclude that the tremendous disparities in nuclear capacity costs among the operating companies disrupt the System's historical pattern of roughly equalizing capacity costs and thus constitute undue discrimination under section 206 of the Federal Power Act.

The second finding upon which the Commission's decision rests—the existence of "unforeseen problems unique to constructing nuclear units," 31 F.E.R.C. (CCH) at 61,655—relates primarily to FERC's choice of means to remedy the undue discrimination on the system. Petitioners do not seriously dispute the existence of this finding; rather, they challenge the use to which it was put by the Commission. For example, the Arkansas-Missouri parties argue that FERC erred by considering facts and circumstances that arose after the execution of the UPSA in evaluating the reasonableness of that agreement. Rather, they assert that the Commission could do no more than "examin[e] the factual circumstances that prevailed at the time the UPSA was formulated in 1979-80." Brief of Petitioners Arkansas Public Service Commission, Missouri Public Service Commission, Arkansas-Missouri Congressional Delegation and State of Arkansas ("Arkansas-Missouri Pet. Br.") at 66; *accord* Brief for Petitioner Arkansas Power & Light Company ("AP&L Pet. Br.") at

45. We find this contention to be completely without merit.

Under the FPA, the Commission has a statutory duty to reform unlawful rates and establish just and reasonable ones, *see* 16 U.S.C. § 824e(a) (1982), and a statutory right to order production of, and to examine, "all accounts, records, and memoranda of licensees and public utilities," *id.* § 825(b), in performing that duty. This, in effect, was the Commission's response on rehearing: "The salient issue here is not whether the agreement was reasonable when made, or whether it met the System objectives at the time it was made. Rather, the principal inquiry is whether the allocation is appropriate based on the evidentiary record that was subsequently developed." 32 F.E.R.C. (CCH) at 61,957.

The Arkansas-Missouri parties appear to ignore this rationale and argue simply that FERC's evaluation of the UPSA in light of subsequent events conflicts with prior Commission precedent. *See* Arkansas-Missouri Pet. Br. at 67-68; AP&L Pet. Br. at 46-48. The cited cases are inapposite to the Commission's review of the UPSA. They establish only that the *prudence* of power supply arrangements and generation construction activities must be evaluated on the basis of circumstances prevailing at the time the activity was undertaken, and are thus limited to "prudence review"—examinations of utilities' decisions to incur costs. The Commission's inquiry is quite distinct. A system's allocation of nuclear capacity costs may not be imprudent on the part of the parties at the time they agree to incur them, but might nevertheless result in present undue discrimination. Accordingly, the cases present no bar to the Commission's reliance on the record to perform its statutory duty under section 206 of the FPA.

AP&L advances an additional argument against the Commission's second finding: "there is no substantial evidence of record put forth by the agency to support its

conclusion that the alleged problems were 'unforeseen.'" AP&L Pet. Br. at 45-46. Besides erroneously placing the burden of proof on the Commission, *see San Luis Obispo Mothers for Peace* v. *NRC*, 789 F.2d 26, 37 (D.C. Cir.) (en banc) (Commission's failure to "include citations to specific pages of the record . . . provides no basis for overturning the Commission's decision"), *cert. denied*, 107 S. Ct. 330 (1986), this objection is simply irrelevant. Even if we assume that the problems were foreseen when the UPSA was negotiated and that the parties *intentionally* entered into an unduly discriminatory agreement, the Commission's duty to reject the agreement as filed would not be diminished.

The Commission's second finding supports the Commission's choice of means to remedy the undue discrimination created by the UPSA and the 1982 System Agreement. That choice was to adopt ALJ Liebman's allocation of Grand Gulf and approve the 1982 System Agreement as filed. We hold that this choice was within the Commission's discretion to remedy the undue discrimination it identified on the System. We first examine the Commission's remedy in more detail and then consider the various petitioners' objections and alternate proposals.

The Commission allocated Grand Gulf responsibility as follows:

AP&L	36%
LP&L	14%
MP&L	33%
NOPSI	17%

See 31 F.E.R.C. (CCH) at 61,633. The effect of this allocation is "not just to allocate Grand Gulf costs, but to allocate the costs of all nuclear capacity on the MSU system." *Id.* This can be seen by following the steps necessary to arrive at this allocation. The System's total nuclear capacity costs are determined by summing the investment costs of all nuclear units on the System, ANO I & II, Waterford III and Grand Gulf. Multiplying this

figure by each company's relative share of total system demand yields each company's total cost responsibility in dollars. The amount of each company's prior nuclear investment costs is then subtracted to yield each company's Grand Gulf cost responsibility. Finally, these figures are divided by Grand Gulf's total investment cost to yield the percentage of Grand Gulf capacity for which each company is responsible. *See* 31 F.E.R.C. (CCH) at 61,655. "The result of this allocation of Grand Gulf is to give each operating company a share of the cost of nuclear capacity roughly proportionate to that company's relative share of system demand . . . ." 26 F.E.R.C. (CCH) at 65,109. The Commission's rationale for adopting this allocation is considered in the context of the various objections and alternate allocations advanced by the petitioners.

C.

Petitioners advance numerous arguments in opposition to the Commission's decision and propose various alternate allocations. We address these arguments in the context of reviewing each proposed alternate allocation.

1. *The UPSA and the 1982 System Agreement*

AP&L and the Arkansas-Missouri parties advocate approval of the UPSA and the 1982 System Agreement as filed. In so doing, they attack the Commission's decision on several grounds. We have already considered and rejected two of these grounds in the preceding section. *See supra* pp. 69-72. The remaining grounds are considered here.

First, AP&L argues that in reforming the UPSA, "the FERC failed to give weight to the Congressional policy favoring voluntary power pooling agreements by 'cavalierly disregarding' the reasonableness of the specific agreements that were filed with the agency." AP&L Pet. Br. at 41 (*quoting ANR Pipeline Co.* v. *FERC*, 771 F.2d 507, 519 (D.C. Cir. 1985)). While it is true that sec-

tion 202(a) of the FPA seeks to encourage voluntary power pooling transactions, *see* 16 U.S.C. § 824a(a) (1982), AP&L's argument is no more than an attack on the Commission's finding that the agreements as filed are unduly discriminatory. But we have already held that that finding is virtually inescapable, given the record in this case, *see supra* pp. 68-69, and we reject any suggestion that the FPA's policy to encourage voluntary power pooling agreements could override the Commission's specific obligation in section 205 of that Act to reject such agreements if found to be "unjust, unreasonable, unduly discriminatory or preferential." 16 U.S.C. § 824e(a) (1982).

Second, the Arkansas-Missouri parties assert that the Commission's decision is "inconsistent with the Commission's own established precedent in *Nantahala Power & Light Company*, Opinions Nos. 139 and 139-A, 19 FERC (CCH) ¶ 61,152 (1982) and 20 FERC (CCH) ¶ 61,430 (1982), *aff'd*, 727 F.2d 1342 (4th Cir. 1984), and *Georgia Power Company*, Opinion No. 711, 52 FPC 1343 (1974), *aff'd*, Opinion No. 711-A, 53 FPC 1103 (1975)." Arkansas-Missouri Pet. Br. at 54. Though these cases involve Commission refusals to equalize costs, they provide no support for petitioners in this case.

Georgia Power involved a challenge to Georgia Power's reliance on its own generation and transmission costs to establish its cost of service. The challenger argued that Georgia Power was part of an integrated electric utility system whose production costs should be allocated to its members on a system, rather than individual company, basis. Finding that the existing allocation was not unjust and unreasonable, the Commission declined to order a "rolled-in" or equalized cost allocation. Petitioners' argument ignores the fact that the FPC found no undue discrimination. The case is distinguishable on that basis alone. Moreover, the *Georgia Power* Commission suggested that a case involving companies' reliance on "large

multi-company generating units which are remote from their service areas" might necessitate some form of cost equalization. *See* 52 F.P.C. at 1349. Grand Gulf is such a unit. Thus, we hold that *Georgia Power*'s refusal to equalize costs in the absence of undue discrimination does not apply where, as here, the Commission found such discrimination in the presence of a multistage generating unit.

Nantahala involved an agreement between Nantahala Power & Light Co. and Tapoco, both wholly-owned subsidiaries of Alcoa, apportioning the capacity and energy which both companies were jointly entitled to receive from the Tennessee Valley Authority. That entitlement arose from a series of agreements among TVA, Alcoa, Nantahala and Tapoco under which Nantahala and Tapoco turned over land and generating facilities to TVA for development of the Fontana Dam in exchange for capacity and energy entitlements. The Commission found the apportionment agreement between Nantahala and Tapoco to be unfair. Though the Commisison declined to order full cost equalization, it increased Nantahala's entitlement to remedy the unfairness. The Commission's decision was based, in part, upon its conclusion that the two companies do *not* operate as an integrated system. *See* 19 F.E.R.C. (CCH) at 61,277. This conclusion was affirmed by the Fourth Circuit as based on substantial evidence. *See Nantahala Power & Light Co.* v. *FERC*, 727 F.2d 1342, 1348 (4th Cir. 1984).

In the case at bar, the Commission's review of the evidence led it to reach precisely the opposite conclusion—that the MSU system is highly integrated. That determination is supported by substantial evidence. *See supra* pp. 66-68. Moreover, the Commission has *not* ordered full production costs, or even nuclear production cost equalization in this case. Rather, as in *Nantahala*, it has ordered a more limited remedy designed only to cure the undue

discrimination found. Thus, petitioners' argument that the Commission went too far in this case is without merit.

Third, AP&L argues that the energy from its "less costly base load generation is displaced from AP&L's usage, to become 'exchange energy' and be sold into the pool for the benefit of the other operating companies." AP&L Pet. Br. at 50. This argument is simply wrong. Under the 1982 System Agreement, AP&L is entitled to first call on its own lowest cost energy, whatever the source. Thus, if ANO I & II produce AP&L's lowest cost energy and AP&L's demand exceeds the amount produced, then AP&L will retain all of the benefits of the ANO units regardless of its Grand Gulf allocation. If anything, more expensive, not less expensive, energy will be displaced. AP&L's real complaint is that it must pay its equitable share of Grand Gulf's *capacity* costs.

Fourth, AP&L argues that the Commission's decision compels it "to pay more for nuclear capacity than is justified by [its] actual ownership costs, and at the same time allows the other operating companies to pay less for nuclear capacity than their actual ownership costs." AP&L Pet. Br. at 55-56 (footnote omitted). This argument is difficult to understand. The premise seems to be that AP&L's "actual ownership costs" are only those associated with ANO I & II, while the other companies' include the costs of Grand Gulf. The premise is incorrect. Under the Commission's allocation, each company is responsible for the costs of its own nuclear units as well as its share of Grand Gulf. AP&L's argument is really that it should pay for none of the costs associated with Grand Gulf—the situation under the UPSA as filed. But, as we have already held, FERC correctly found that the UPSA allocation results in unlawful discrimination.

In short, AP&L and the Arkansas-Missouri parties have advanced no persuasive argument against the Commission's decision to reject the UPSA as filed.

2. *ALJ Head's Allocation*

Petitioners City of New Orleans, Mississippi Industries, MP&L, and Representative Webb Franklin, and intervenor Representative Wayne Dowdy support the Commission's finding of undue discrimination, but argue that the Commission erred in deciding to equalize all nuclear capacity costs. Rather, they assert that the Commission should have adopted ALJ Head's solution of equalizing only the investment costs associated with Grand Gulf. *See* Consolidated Brief of Petitioners Mississippi Industries, Mississippi Power & Light Company, and Representative Webb Franklin, and Intervenor Representative Wayne Dowdy ("Consolidated Pet. Br.") at 60-61; Brief of Petitioner City of New Orleans, Louisiana ("New Orleans Pet. Br.") at 48-50.

Putting aside for the moment these petitioners' arguments *against* the allocation ordered by FERC, we have little difficulty affirming FERC's rejection of Judge Head's solution. That solution rests on Judge Head's finding that Grand Gulf is an anomaly on the MSU System—the only facility planned and constructed for the benefit of the system as a whole. *See* 30 F.E.R.C. (CCH) at 65,170-72. FERC expressly rejected this finding, concluding instead that Grand Gulf was "planned in the same manner as the other nuclear units on the System." 31 F.E.R.C. (CCH) at 61,654. Thus, Judge Head's solution is viable only if we conclude that the Commission's findings concerning the integration of the MSU System and the status of the Grand Gulf unit are not based on substantial evidence. We have already concluded that they are. *See supra* pp. 66-68.

In advocating adoption of Judge Head's solution, petitioners rely primarily on three arguments against FERC's chosen allocation. First, they assert that the Commission's decision irrationally allocates 33% of Grand Gulf to MP&L, an increase over the 31.63% allocated to MP&L

under the unduly discriminatory UPSA. Second, they argue that FERC did not adequately explain why it focused on nuclear but not coal facilities in equalizing capacity costs. Third, they assert that MP&L and NOPSI receive less nuclear capacity per nuclear investment dollar than does AP&L. As explained below, we find that none of the arguments advanced by these petitioners requires reversal of the Commission's decision.

Petitioners' first objection is that "[t]he Commission failed to reconcile its allocation scheme imposing 33 percent of Grand Gulf costs on Mississippi with the finding that a 31.63 percent allocation was detrimental and unjustified." Consolidated Pet. Br. at 39. The argument is that because the UPSA was found to be unduly discriminatory, an allocation to MP&L greater than that found in the UPSA necessarily must be unlawful. The argument misconstrues the nature of the statutory inquiry. The question is whether the agreement is unduly discriminatory or preferential. Thus, there is no inconsistency in the Commission's determination that the UPSA's allocation of 31.63% of Grand Gulf to MP&L and 0% to AP&L is unduly discriminatory but that a 33% allocation to MP&L and a 36% allocation to AP&L is not. That is because a party claiming discrimination, by definition, objects only to his treatment as compared to that of other similarly situated parties. Thus, the reasonableness of the Commission's allocation may be judged only by examining the relative impact on the four operating companies and the degree to which they are similarly situated.

Petitioners' second argument is no more availing. They assert that "the system's planned shift to primary reliance on coal and nuclear generation . . . plainly does not support focusing exclusively on nuclear generation and excluding coal-fired baseload units from that formula." Consolidated Pet. Br. at 45-46; *accord* New Orleans Pet. Br. at 43. This argument is misleading. While the Sys-

tem's move toward coal and nuclear facilities might support equalization of the capacity costs of both coal and nuclear units, it does not *preclude* FERC's decision to equalize only the investment costs of the nuclear units. Petitioners' argument ignores the Commission's explicit finding that the unforeseen problems that led to dramatic cost overruns were "unique to constructing nuclear units." 31 F.E.R.C. (CCH) at 61,655 (footnote omitted). In this circumstance, we find that the Commission's focus on nuclear but not coal units was rational.

Petitioners argue further that "[t]o the extent that unexpectedly high costs of [nuclear] facilities support special allocation treatment, the stated reason supports only a grouping of Grand Gulf 1 and Waterford 3." New Orleans Pet. Br. at 44; *see* Consolidated Pet. Br. at 46-47. They argue that to include the ANO units but not the coal units was arbitrary and capricious since the investment costs of the former are comparable to those of the latter. To be sure, this fact would have justified a Commission decision to equalize only the investment costs of Grand Gulf and Waterford III. (Interestingly, neither these petitioners nor any others have advanced this option here or below.) But, we conclude that the Commission also rationally could include the ANO units. Indeed, FERC decided to include them precisely because their investment costs were *not* comparable to those of the more recent nuclear units. The Commission decided to equalize the investments cost of all nuclear units because their widely divergent costs were due solely to the timing of their construction, *see* 32 F.E.R.C. (CCH) at 61,960-61, a reason insufficient to justify the differences.

Petitioners' third argument is that the Commission's allocation is itself unduly discriminatory because it allocates only the investment costs of nuclear capacity but not the benefits produced by that capacity. Thus, "MP&L must pay approximately 15 percent of the aggregate cost of nuclear capacity on the MSU system, but receives the

benefit of only 9.5 percent [(or 371 megawatts)] of that capacity." Consolidated Pet. Br. at 63. AP&L, on the other hand, is responsible for only 33% of the System's nuclear investment costs, but is entitled to first call on the energy produced by 2099 megawatts, or 53.5%, of that capacity. *See* 26 F.E.R.C. (CCH) at 65,109. In addition, LP&L pays for 44%, and NOPSI pays for 8%, of the System's nuclear capacity costs, but receive only 1262 megawatts (or 32%), and 191 megawatts (or 5%), of nuclear capacity, respectively. *See id.* The reason for these differences is that AP&L's nuclear capacity is made up of inexpensive ANO capacity as well as capacity from Grand Gulf; all other operating companies' nuclear capacity is composed entirely of expensive Grand Gulf and Waterford III capacity.

In our opinion, the Commission acted within its discretion in ordering equalization of nuclear investment costs without equalization of nuclear capacity. The Commission's allocation serves to restore a *rough* equalization of all System capacity costs among the operating companies. In view of the fact that such costs have never been precisely equalized on the System, FERC was required to do no more to remedy the undue discrimination it found. As the Commission emphasized on rehearing:

> What our decision purports to do is to eliminate *drastic* rate disparities at the wholesale rate level which are associated with units used for the mutual benefit of all companies, and to do so in a manner which disturbs the historical operation of the System as little as possible, and which allows the individual companies to retain as fully as possible the benefits of units they have financed and constructed. In other words, we have sought to achieve an equitable balance between the interests of the individual companies and the System as a whole, consistent with the System Agreement.

32 F.E.R.C. (CCH) at 61,959 (emphasis added).

Petitioners' argument is even less persuasive when it is recalled that these petitioners advocate adoption of

Judge Head's solution as just and reasonable. Judge Head's solution was to allocate only the costs and capacity of Grand Gulf in proportion to each company's relative share of System demand, without regard to prior nuclear investment. But under this scheme, MP&L's nuclear cost responsibility as a proportion of total System nuclear costs would still exceed its proportion of total System nuclear capacity. This is so because although AP&L would be allocated a greater share of Grand Gulf responsibility, it would still be able to reduce its *average* nuclear capacity costs, with capacity from its less expensive ANO units; MP&L's nuclear capacity, though smaller, would still consist entirely of expensive Grand Gulf capacity. Petitioners' simultaneous claims that FERC's allocation must be rejected as unduly discriminatory because it mismatches nuclear costs and capacity and that an alternate allocation that also fails to match nuclear costs and capacity is just and reasonable reveals the real reason for their support of Judge Head's solution. It is not that it resolves the flaws they see in the FERC allocation, but simply that it allocates them less Grand Gulf responsibility. Under these circumstances, the objection that the Commission mismatched costs and benefits rings rather hollow.

The City of New Orleans advances an additional reason why the Commission's allocation should be considered unduly discriminatory: AP&L's average cost for the nuclear *energy* produced by its capacity is 5.7 cents per kWh while the average cost of the nuclear energy produced by the other companies' nuclear capacity is 15 cents per kWh. *See* New Orleans Pet. Br. at 35. The objection is apparently that the Commission failed to equalize the companies' nuclear *production* costs and that this failure results in unduly discriminatory rates. Again, it is curious that this objection comes from a party that advocates adoption of Judge Head's solution since that solution seeks only to equalize Grand Gulf *capacity* costs,

not nuclear production costs. Nevertheless, the objection does not undermine FERC's allocation.

The Commission's decision sought only to remedy the drastic disparities in the costs of building the System's nuclear capacity by roughly equalizing the investment cost of that capacity among the companies. That step was considered sufficient to restore rough equality among the companies' overall capacity costs. Petitioner's objection is that the Commission failed to equalize nuclear *production* costs—*i.e.*, the costs of producing nuclear energy. There is no reason for the Commission to have focused on nuclear production costs rather than overall production costs. As previously discussed, only Grand Gulf energy is allocated with capacity. All other energy —whatever its source—is allocated pursuant to the 1982 System Agreement, with each company entitled to first call on its own lowest cost energy. Historically, and under the 1982 System Agreement, production costs have never been precisely equalized. These costs varied from company to company depending on each company's fuel mix at any given time. ALJ Head reviewed the companies' relative projected average annual production costs over a nine-year period under several alternative allocations. *See* 30 F.E.R.C. (CCH) at 65,156-57. For example, the nine-year average of production costs under the 1982 System Agreement as filed would be as follows:

AP&L — 7.47 cents/kWh
LP&L — 8.59 cents/kWh
MP&L — 11.00 cents/kWh
NOPSI — 11.65 cents/kWh

See id. at 65,157. The nine-year average under one of the production cost equalization proposals would be as follows:

AP&L — 8.82 cents/kWh
LP&L — 7.61 cents/kWh
MP&L — 9.46 cents/kWh
NOPSI — 8.96 cents/kWh

See id. Despite the production cost disparities under the 1982 System Agreement, Judge Head found no undue discrimination: "none of the differences brought out on the record are so compelling that they require the adoption of one form of production cost allocation." *Id.* at 65,169. Accordingly, he approved the 1982 System Agreement as filed.

Like ALJ Liebman, however, Judge Head found undue discrimination in the System's allocation of *capacity* costs. Unlike Judge Liebman, however, Judge Head believed this discrimination could be remanded by equalizing the investment costs of Grand Gulf alone rather than all nuclear capacity on the System. *See id.* at 65,172. Moreover, Judge Head pointed out that allocating AP&L a share of Grand Gulf capacity and energy would also serve to reduce the *production* cost disparities identified under the 1982 System Agreement. *See id.* at 65,169.

In view of Judge Head's above findings, affirmed and adopted by the Commission, *see* 31 F.E.R.C. (CCH) at 65,656, petitioner City of New Orleans' suggestion that production cost disparities among the companies require reversal of FERC's decision must be rejected. We affirm the finding by Judge Head and the Commission that production cost disparities under the 1982 System Agreement do not amount to undue discrimination. In deciding what discrimination is "undue," the Commission necessarily possesses discretion and exercises judgment in light of the facts established by the record. In this case, Judge Head identified "a strong factual reason for not restructuring the system to meet the current [production] cost disparity problems": "production cost equalization would be inconsistent with the history of intercompany transaction on the Middle South system." 30 F.E.R.C. (CCH) at 65,179. Like Judge Head's solution, the Commission's decision alters the UPSA by allocating AP&L a share of Grand Gulf responsibility. Indeed, since the Commis-

sion's decision allocates AP&L more Grand Gulf responsibility (36%), the former does even more than the latter to reduce the production cost disparities among AP&L and the other companies.

3. *Participation Unit Concept*

The remaining Mississippi petitioners—the Mississippi Public Service Commission, the Mississippi Attorney General, and the Mississippi Legal Services Coalition—raise many of the arguments relied on by the petitioners who support Judge Head's solution. These petitioners, however, urge a return to the participation unit method of allocating the System's excess capacity.

Like the other Mississippi parties, these petitioners argue that the Commission's decision mismatches nuclear investment costs and benefits and irrationally increases MP&L's Grand Gulf responsibility from 31.63% to 33%. We have already considered and rejected these arguments, *see supra* pp. 76-80, and these petitioners' contentions require only minimal additional discussion.

In objecting to the Commission's decision to increase MP&L's Grand Gulf responsibility, petitioners take issue with the Commission's observation that the result of its decision "is that all three major geographical areas served by the MSU System will share similar Grand Gulf cost burdens: AP&L—36%; MP&L—33%; and LP&L/NOPSI—33%." 32 F.E.R.C. (CCH) at 61,960. They claim that this "response" is "grossly inadequate" to explain why the Commission's allocation to MP&L is just and reasonable while the UPSA's slightly smaller allocation is not. *See* Brief of Petitioners, The Mississippi Public Service Commission, Edwin Lloyd Pittman, Attorney General for the State of Mississippi, and Mississippi Legal Services Coalition ("Mississippi Pet. Br.") at 56. Rather than focusing on geographical areas, they assert, "one must look at the actual size of each company in

order to assess the impact of the Grand Gulf allocation or cost burden on that company's individual ratepayers." Mississippi Pet. Br. at 60. This argument misunderstands the significance of the Commission's observation. Contrary to petitioners' suggestion, the Commission has not stated that any allocation that spreads costs proportionately over geographic regions is just and reasonable. By allocating nuclear investment costs according to relative demand, the Commission expressly recognized that Arkansas, Mississippi and Louisiana do not have equal loads. The Commission's point is simply that its allocation, unlike the UPSA's, requires Arkansas to bear a proportionate share of nuclear investment costs. It was the *relative* impact of the UPSA that FERC found unduly discriminatory. By requiring AP&L to share in the costs of Grand Gulf, the Commission could reasonably adopt an allocation that also slightly increased MP&L's responsibility.

We also have little difficulty rejecting petitioners' submission that "the participation unit concept utilized under the 1973 System Agreement is a concept for equalizing excess capacity which is . . . just, reasonable, and not unduly discriminatory." Mississippi Pet. Br. at 73. Under this proposal, the System would return to the 1973 System Agreement with MSE, the MSU subsidiary that owns Grand Gulf, as a party. Since MSE is not an operating company and has no demand, it will always be "long" on capacity, making Grand Gulf a participation unit. This means that the responsibility for Grand Gulf would be borne entirely by the "short" companies, shifting somewhat over time as the operating companies became more or less long or short.

Both Judge Liebman and Judge Head concluded that this proposal would be unduly discriminatory. *See* 30 F.E.R.C. (CCH) at 65,167; 26 F.E.R.C. (CCH) at 65,112. The Commission adopted and affirmed the findings of both judges on this point. *See* 31 F.E.R.C. (CCH)

at 61,655-56. These findings are conclusively established by the record. Petitioners acknowledge that MP&L is currently a "long" company and expected to remain so for approximately ten years. This means that LP&L and NOPSI, the "short" companies, would bear almost all of the responsibility for Grand Gulf during this period. That the proposal would result in profound discrimination is most readily seen by observing its impact on LP&L. As discussed, Grand Gulf and Waterford III are unique on the System in that it is the dramatic cost escalations of these units that disrupted the System's rough equalization of capacity costs among the operating companies. *See* 31 F.E.R.C. (CCH) at 61,654; *supra* pp. 69-71. Already saddled with 100% of the costs of Waterford III, LP&L would be required under petitioners' proposal to pay 90 to 100% of the costs of Grand Gulf over the next ten years. *See* 26 F.E.R.C. (CCH) at 65,112. As Judge Head recognized, the astronomical costs of Grand Gulf and Waterford III mean that these two units alone "will account for over 70% of the total system investment in production plant." 30 F.E.R.C. (CCH) at 65,145. Requiring one company to bear virtually all of the costs of both units exaggerates rather than alleviates the undue discrimination found under the UPSA and 1982 System Agreement. The Commission properly rejected this proposal.

4. *Production Cost Equalization*

The Louisiana petitioners—the Louisiana Public Service Commission, the State of Louisiana, Occidental Chemical Corporation, Georgia Gulf Corporation, and Jefferson Parish, Louisiana—support the Commission's finding of undue discrimination, but argue that some form of production cost equalization would be a more equitable and efficient remedy than the one ordered by the Commission. Petitioners' main contention is that the Commission failed adequately to explain its decision not to order full production cost equalization. We find this contention with-

out merit and hold that the Commission acted within its discretion in ordering a less intrusive means of remedying the undue discrimination found on the System.

Petitioners argue at length that, like the Commission's remedy, "production cost equalization is also fully supported by the Commission's conclusions of law and findings of fact, and that [the] latter alternative would more directly and more expeditiously achieve the objectives identified by the Commission as the basis for adopting nuclear investment equalization." Initial Brief of Petitioners Occidental Chemical Corporation, Georgia Gulf Corporation, and Jefferson Parish, Louisiana ("Louisiana Parties' Pet. Br.") at 33; *see* Brief of the Louisiana Public Service Commission and the State of Louisiana, Petitioner and Intervenor ("Louisiana Pet. Br.") at 44-47. Petitioners are surely correct in their assertion that production cost equalization would "virtually eliminate[] the possibility of serious future imbalances in generation cost responsibility among the operating companies." Louisiana Parties' Pet. Br. at 36. That, of course, is the nature of the remedy. But we have also concluded that the Commission's chosen remedy is sufficient to remedy the *undue* discrimination on the System; that is, the Commission could properly conclude that the remaining cost disparities do not constitute unlawful discrimination. *See supra* pp. 79-83. The Louisiana parties do not seriously dispute this conclusion. *See* Louisiana Pet. Br. at 39. Rather, their argument is that production cost equalization would remedy System cost disparities even more effectively than nuclear investment cost equalization and that the Commission did not adequately justify its decision to reject the former and adopt the latter. *See* Louisiana Parties' Pet. Br. at 42, 49.

In deciding whether to order production cost equalization or nuclear investment equalization, the Commission confronted a major policy choice. Though both alternatives would remedy undue discrimination, the former

would represent a dramatic disruption of the System's historical operations and of the states' settled interests and expectations. Accordingly, FERC chose the latter alternative. We hold that the Commission's decision was both rational and within its discretion.

Under the Louisiana Public Service Commission's production cost equalization proposal, the investment costs of all System capacity would be combined and allocated among the operating companies according to each company's capability responsibility—that proportion of System capacity equal to each company's proportion of System demand. *See* 30 F.E.R.C. (CCH) at 65,141. In addition, a rate would be established to equalize cost per kWh of all energy produced by that capacity. *Id.* After reviewing the historical operation of the System, Judge Head concluded that "production cost pooling and equalization constitutes a drastic deviation from past practices on the system relating to intercompany transactions and would change the underlying nature of such transactions." *Id.* at 65,168.

> Never during the modern history of the system (1949 on) has there been any arrangement governing intercompany transactions where all the costs of the production plants of the operating companies have been combined and then allocated to the respective operating companies based on some capability responsibility formula.

Id. at 65,167. Rather, the operating companies have always been responsible for the costs associated with the plants they build and finance, costs that necessarily vary somewhat from company to company. In addition, the companies have always had first call on their own lowest cost energy in meeting their demand. The System agreements have sought simply to equalize the System's *excess* energy and capacity among the companies. The *result* has been *rough* equalization of capacity and production costs.

Having found that "it is the large cost escalations of Grand Gulf and Waterford that have disrupted this pattern [of rough equalization]," 31 F.E.R.C. (CCH) at 61,654, the Commission properly decided to take only those steps that were necessary to compensate for this disruption. Those steps were to approve the 1982 System Agreement as filed and order nuclear capacity cost equalization. Production cost equalization would go much further and eliminate virtually all production and capacity cost disparities among the companies. Though we do not say that the Commission could not have ordered production cost equalization on this record, we think that the Commission correctly concluded that it was not necessary to remedy the undue discrimination found on the System. Recognizing that "[f]ull production cost equalization would be a substantial change from the allocation methodologies historically used on the MSU System," 32 F.E.R.C. (CCH) at 61,961, the Commission explained that "the adopted allocation is an attempt to equalize the imbalance of cost on the System with the least disruption possible to the historical operation of the System." *Id.*

Judge Head identified an additional "compelling" policy consideration against production cost equalization: "Federal regulation is meant to be supplemental to, not to supplant, State regulation." 30 F.E.R.C. (CCH) at 65,170. Observing that "the practical effect of ordering production cost equalization would be to bind the local State commissions in many of their rate base determinations," *id.*, Judge Head concluded that the reasons favoring equalization "are not so compelling that they justify the extensive intrusion into an area normally subject to regulation by the State commissions." *Id.* The Commission affirmed this conclusion, *see* 31 F.E.R.C. (CCH) at 61,656, and stated that its decision seeks "to alter in as limited a means as possible the agreed-upon cost scheme, in order to achieve just, reasonable, non-discriminatory and non-preferential rates." 32 F.E.R.C. (CCH) at 61,961. Having determined that production cost equalization was not

necessary to achieve lawful rates, the Commission properly considered the historical operation of the System as well as the regulatory interests of the states in exercising its discretion not to order such equalization. *Cf. Nantahala Power & Light Co.* v. *FERC*, 727 F.2d at 1348 ("A decision to order roll-in is essentially a matter of Commission discretion . . . .").

* * * *

We have now considered petitioners' numerous arguments against the Commission's decision and in favor of various alternate allocations. We find these arguments unpersuasive and hold that the Commission acted within its authority to remedy undue discrimination and that its decision was rational. We also have considered all other arguments suggesting that the Commission acted improperly and find them to be without merit.

D.

In this section, we consider two remaining claims: that Commissioner Richard improperly failed to recuse himself and that the Commission abused its discretion in failing to reopen and update the record.

1. *Recusal*

Several of the Mississippi parties assert that "[t]he failure of Commissioner Oliver G. Richard, III to recuse himself in this case was error." Mississippi Pet. Br. at 71. Their claim is that Commissioner Richard's past association with Senator J. Bennett Johnston of Louisiana —an intervenor below as a member of the full Louisiana congressional delegation—"created the appearance of bias and impropriety sufficient to compel the Commissioner's recusal." Mississippi Pet. Br. at 72. Like Commissioner Richard and the Commission, we find petitioners' claim to be without merit.

Recusal is required only when the actions of a decisionmaker lead one to conclude that he has prejudged the case.

See Cinderella Career & Finishing Schools, Inc. v. *FTC*, 425 F.2d 583, 591 (D.C. Cir. 1970). Petitioners themselves acknowledge that recusal decisions are subject to a very deferential, abuse of discretion standard of review. *See* Mississippi Pet. Br. at 72 (*citing Davis* v. *Board of School Comm'rs of Mobile County*, 517 F.2d 1044 (5th Cir. 1975)). Under this standard, it is clear that Commissioner Richard acted properly.

Commissioner Richard worked for Senator Johnston from 1977 to 1981 as a legislative assistant dealing with energy issues. This fact alone does not suggest bias. As Commissioner Richard observed, "my employment with the Senator ended . . . almost one year before the *Middle South* proceedings began. I had no prior contact with the facts or legal issues involved in *Middle South* before joining the Commission in 1982." 31 F.E.R.C. (CCH) at 61,671. Petitioners do not dispute these facts. Rather, they claim that Commissioner Richard abused his discretion by "neglect[ing] to follow FERC's own Administrative Rules." Mississippi Pet. Br. at 72 (*citing* 18 C.F.R. § 385.504(c)(1), (2)). We disagree.

First, these rules do not apply to the Commissioners; they are directed only to presiding officers at hearings ordered by the Commission. Second, even if applicable, the rules would not support petitioners' claims. They provide simply that a presiding officer who believes himself to be "disqualified" may withdraw from a hearing, *see* 18 C.F.R. § 385.504(c)(1), and that the Commission may order recusal "upon good cause," *see id.* § 385.504 (c)(2).

2. *Reopening the Record*

The Louisiana petitioners assert that the Commission arbitrarily and capriciously refused to reopen the record to update the cost estimates of Grand Gulf and Waterford III. We find petitioners' arguments unavailing and

hold that the Commission acted within its discretion in deciding not to reopen the record.

In *ICC* v. *Jersey City*, 322 U.S. 503 (1944), the Supreme Court established the general rule that federal courts should be extremely reluctant to require an agency to reopen a record on the ground that the evidence has become stale. *Id.* at 514. Indeed, the question is often "entrusted to agency discretion." *See Delta Air Lines* v. *CAB*, 561 F.2d 293, 307 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1045 (1978); *accord Bowman Transp.* v. *Arkansas-Best Freight Sys.*, 419 U.S. 281 (1974). As a general rule, this court has found that a remand may be necessary "where there has been a change in circumstances . . . that is not merely 'material' but rises to the level of a change in 'core' circumstances, the kind of change that goes to the very heart of the case." *Greater Boston Television Corp.* v. *FCC*, 463 F.2d 268, 283 (D.C. Cir. 1971), *cert. denied*, 406 U.S. 950 (1972). We cannot conclude that the circumstances cited by petitioners evidence a change which goes "to the heart of the case" or that they represent a change in the "core circumstances."

In this case, the Commission adopted Judge Liebman's remedy, which relied on the cost data in the record developed before him. In rejecting the Louisiana parties' request to reopen the record, the Commission stated: "Because cost estimates for these units have been continually changing and because the costs as well as demand projections in ER82-616 were reasonable when made and were subject to cross-examination, we find it appropriate to adopt Judge Liebman's recommendation without modification at this time." 31 F.E.R.C. (CCH) at 61,657. The Commission took the same position on rehearing, stating that "it is necessary to use some fixed point in time in order to provide finality to a proceeding, rather than continuously updating or using spot adjustments." 32 F.E.R.C. (CCH) at 61,961.

Petitioners argue that the Commission should have reopened the record on rehearing because by that time final cost figures were available for both Grand Gulf and Waterford III. Use of these costs, they argue, would have better served the interests of finality. But, updating the record would not have been as effortless as petitioners suggest. First, the intervening increase in costs cited by petitioners has never been subject to cross-examination, and AP&L, at least, suggests that the amount is subject to dispute. *See* Brief of Arkansas Power & Light Company as Intervenor at 28 n.23. Moreover, AP&L claims that the intervening improvements it has made to ANO I and II by order of the NRC would also have to be considered in any recalculation based on updated costs. Second, the Commission could not merely update cost figures; demand projections would have to be revised as well since both are necessary to properly equalize nuclear capacity costs. Thus, we cannot agree with petitioners that finality could have been better served by reopening the record. The potential delay involved might have been seriously detrimental since Grand Gulf was about to become operational and the matter had to be resolved.

Petitioners make much of the fact that the Commission considered extra-record evidence to increase the rate of return on equity it allowed MSU. "Given its willingness to consider post-record evidence in adjusting the rate of return, to benefit the utility, the FERC should have taken similar action to avoid discrimination among consumers." Louisiana Pet. Br. at 44. Petitioners' claim is unpersuasive. Setting rates of return is a completely different undertaking from allocating costs. *See Illinois Power Co.*, 15 F.E.R.C. (CCH) ¶ 61,650 (1981). In the case of the former, the Commission frequently adjusts the return upward when warranted by changing circumstances in the financial markets after the close of the record since such information is not typically subject to dis-

pute. As discussed, cost allocation involves information of a quite different character. Thus, we must conclude that petitioners have fallen "far short of demonstrating 'the most extraordinary circumstances' necessary to justify compelling the agency to reopen the record." *Nantahala Power & Light Co.* v. *FERC*, 727 F.2d at 1352 (*quoting Bowman*, 419 U.S. at 296).

For all of the foregoing reasons, the Commission's decision is

Affirmed.

BORK, *Circuit Judge, concurring in part and dissenting in part*: I concur in the majority's reasoned analysis of the jurisdictional challenges raised in this case. I dissent from the majority's affirmance of the merits of the Commission's decision because I believe that the Commission has failed adequately to explain two critical issues. I would reverse and remand for further consideration of these issues.

First, the Commission has not explained adequately its criteria for determining what is "undue discrimination" or why the course it has chosen is not also unduly discriminatory. The Commission found the UPSA as filed to be unduly discriminatory because the cost of nuclear capacity varied widely from company to company. Specifically, the Commission found the companies' costs of nuclear capacity were approximately as follows:

AP&L	$ 531,000 per megawatt
LP&L	2,211,000 per megawatt
MP&L	2,247,000 per megawatt
NOPSI	2,090,000 per megawatt

See 26 F.E.R.C. (CCH) at 65,107. Under the Commission's remedy, however, nuclear capacity costs remain vastly disparate:

AP&L	$ 858,000 per megawatt
LP&L	2,219,000 per megawatt
MP&L	2,156,000 per megawatt
NOPSI	2,094,000 per megawatt

See id. at 65,109. Those are still very large differences. Indeed, the disparities have changed hardly at all. In response to the argument that this result was also unduly discriminatory, the Commission stated:

> What our decision purports to do is to eliminate drastic rate disparities at the wholesale rate level which are associated with units used for the mutual benefit of all companies, and to do so in a manner which disturbs the historical operation of the System

> as little as possible, and which allows the individual companies to retain as fully as possible the benefits of units they have financed and constructed. In other words, we have sought to achieve an equitable balance between the interests of the individual companies and the System as a whole, consistent with the System Agreement.

32 F.E.R.C. (CCH) at 61,959.

This explanation is inadequate for three reasons. First, the Commission does not explain why the remaining very great disparities should not be considered "drastic" and hence to constitute "undue discrimination." No criteria whatever are offered for determining when such discrimination exists. Second, the argument that the Commission did not want to disturb the historical operation of the System does not support its finding because historically costs were equalized under the System. Finally, the Commission's statement that it has attempted to allow "individual companies to retain as fully as possible the benefits of the units they have financed and constructed" is unacceptable as a rationale. As discussed at length in the majority opinion, a basic, and necessary, premise of the Commission's jurisdiction in this case, as well as the validity of the decision, is that the companies are not autonomous and that decisions are made for the System as a whole. *See* maj. op. at 33-39, 66-68.

Second, I believe that the Commission's explanation for its decision to include the capacity costs of all nuclear plants, rather than considering only the costs of Waterford III and Grand Gulf, or the costs of all coal and nuclear plants, is not rational. The Commission considered the capacity costs of all nuclear plants because the unforeseen problems that led to dramatic costs overruns were "unique to constructing nuclear units." 31 F.E.R.C. (CCH) at 61,655. But the cost overruns were not unique to all nuclear plants; they were unique only to Grand Gulf and Waterford III. The investment costs of the

ANO units were comparable to the investment costs of the coal units. *See* 32 F.E.R.C. (CCH) at 61,960. Thus, if the Commission was attempting only to address the "unique" cost overruns, which it has stated as its rationale, then it would seem reasonable to consider only the costs of Grand Gulf and Waterford III. If, however, the Commission wished to include the costs of the ANO units, for some unexplained reason, then, it would appear, the Commission reasonably should have included the costs of the coal units as well.